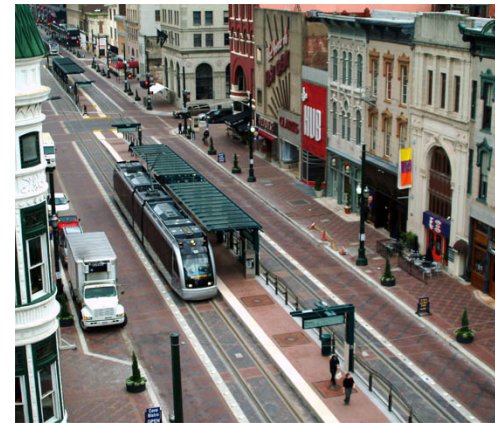


RETOOLING HUD

for a CATALYTIC FEDERAL GOVERNMENT:
A REPORT to SECRETARY SHAUN DONOVAN



PENN INSTITUTE *for* URBAN RESEARCH

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A REPORT to SECRETARY SHAUN DONOVAN

Penn Institute for Urban Research
University of Pennsylvania

February 2009

Paul C. Brophy
Rachel D. Godsil
Project Directors



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Penn Institute for Urban Research
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PREFACE

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

Faced with a national economic crisis that is reverberating through all of its work, but poised to react forcefully in addressing this challenge and others like global warming, the U.S. Department of Housing and Urban Development (HUD) has an opportunity to reposition itself as a 21st century engine of innovation in U.S. metropolitan areas. With the thoughtful leadership of its new Secretary, Shaun Donovan, HUD can take advantage of its more than forty years of experience to focus on key strategic initiatives outlined in this document. HUD can refine its mission, making it more suited to today's conditions; it can redesign its programs accordingly; and it can fashion its administrative structure to accomplish these goals.

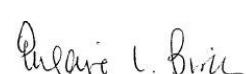
Retooling HUD for a Catalytic Federal Government: A Report to Secretary Shaun Donovan offers important advice on how to approach today's challenges. It is comprised of reports by ten task forces, led by Paul C. Brophy and Rachel D. Godsil, and reflects the work of more than 50 members, drawn from practice and the academy, who have urban and metropolitan policy and housing experience spanning many decades. Its recommendations emanate from these experts' passionate concern for, and deep intellectual interest in metropolitan areas. The document seeks to advance HUD's mission and the public good – not any particular point of view or set of interests.

This report reinforces HUD's concern for providing a decent home for every American and strengthening cities but also calls for HUD to create new opportunities – to promote greening, target revitalization efforts, partner meaningfully with sister agencies, leverage anchor institutions, and include a regional perspective. Bold, innovative, and strategic, the collective recommendations offer HUD a powerful roadmap for a new federal government's role in housing and urban development.

The Penn Institute for Urban Research has been proud to sponsor this work. We are immensely grateful for the work of the team leaders, Paul Brophy and Rachel Godsil, the Task Force Chairs – John Cleveland, Anne Evans, Rosanne Haggerty, Bart Harvey, Ira Harkavy, Edward Hill, Dan Kildee, Jeff Lubell, Pete Plastrik, Wendell Pritchett, Fran Stewart, Charlie Werhane, Hal Wolman, Barry Zigas – and the entire Task Force membership who produced this report in record time. Their energy, enthusiasm, and thoughtful contributions are apparent.

We are also profoundly appreciative of the Rockefeller Foundation who supported this effort at a critical time.

Finally, thanks are due to Penn IUR staff members, Maritza Mercado, Amy Montgomery, Daniel Stout, and Selina Zapata, for their editorial assistance.


Eugénie L. Birch


Susan M. Wachter

Co-Directors, Penn Institute for Urban Research

EXECUTIVE SUMMARY

Retrofitting HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

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University of Pennsylvania

The election of Barack Obama as President of the United States is rightly being heralded as a major world event. He ran a transformative campaign – inviting the American people to join a movement rather than merely supporting a candidate. Now, as he begins to govern with crises at home and abroad, President Obama and those at the helm of his Administration face unprecedented challenges but also have unique opportunities. The American people have rallied behind the idea that the federal government has a critical role to play in domestic prosperity as well as national security. At the same time, Americans are engaged in the political process and eager to be part of the solutions to our country's challenges.

As a candidate, President Obama offered the vision of a renewed federal government and a revitalized role for Americans. This promise extends to the potential to transform how the federal government approaches the nation's cities and metropolitan areas and to fundamentally rethink programs and policies to address our nation's acute housing needs and improve the economic, social, and civic health of our cities and metropolitan areas.

President Obama now has the opportunity to make good on his campaign promise that cities and metropolitan areas will not be treated as problems to be solved or as areas where constituencies have to be managed, but will be properly understood as the essential building blocks of our national economy. America's economy is largely based on the strength of its metropolitan areas, and President Obama acknowledges the strengths, potential, and economic importance of the nation's cities and metropolitan areas.

This vision of our cities and the anticipation that the federal government can be a partner in their growth and revitalization is not itself new; but it is vastly more likely to be realized than ever before. When previous administrations have sought to engage the federal government in the work of rebuilding our cities, they have been stymied by political push-back from multiple perspectives: some argued that cities were too far gone to be worthy of investment; some that government should merely allow markets to function; and others were impatient with the slow rate of change from government programs, demanding more radical action.

The perception of cities has changed in the last decade. We've had quite dramatic reductions in crime in major cities since the 1990s – and a reversal in the population exodus. Until very recently cities have been doing quite well. The urban unemployment rate was down, and homeownership rates for Latinos and blacks had increased. Formerly viewed as places of exceptional poverty, the poverty rate in central cities has not substantially differed from the nation's overall poverty rate: both have been lower than in the past 25 years. We have even seen reports of improved air quality in many urban areas.

These changes – combined with the economic reality that cities and metropolitan areas are the source of our economic growth and innovation – mean that President Obama's framing of these places as essential building blocks of a robust national economy resonates in a way it may not have when crime and urban poverty were higher and more vivid a part of our picture of cities.

The possibilities for federal involvement in building healthy and sustainable communities are tremendous, but the challenge of repositioning the federal government, and the U.S. Department of Housing and Urban Development (HUD) especially, to achieve this new vision, is massive. HUD needs a fundamental reorientation in its approach and a concomitant increase in its capacity if it is to continue to emphasize its critical housing role while building its capacity to work in partnership with state and local governments, local stakeholders, and citizens to improve neighborhoods, cities, suburbs, and metropolitan areas.

Responding to the nation's immediate challenges will require establishing the policies, programs, and systems that permit HUD to become a successful partner with state and local governments and with the private sector (for-profit and non-profit) to improve the economy of our metropolitan areas, to bring HUD into the role of helping to solve the foreclosure crisis upon the nation, to reposition HUD's housing production and finance programs, and to enlist our citizenry in the work of community building.

After considerable communication with members of the HUD Transition Team and with support from the Rockefeller Foundation, the Penn Institute for Urban Research assembled some of the most thoughtful and experienced professionals in the fields of housing and urban and metropolitan development to produce this report to Secretary Donovan. The issues covered by the task forces are not comprehensive – we have not dealt with every program or issue in the HUD portfolio, but have concentrated on those areas where the Transition Team suggested that help from outside experts could be of particular value.

This Report conveys the work of these task forces.

Rather than provide a program-by-program breakout, these task forces were instructed to tackle key thematic and programmatic areas and to focus on strategies to make HUD more effective in a catalytic federal government. The task forces were also encouraged to be bold and ambitious but also grounded and pragmatic – and to present short- and long-term recommendations.

Each task force consisted of a small group of experts who volunteered their time to produce a report and was chaired or co-chaired by leaders who took responsibility for managing the task forces and preparing each task force report. Bringing together a wide array of perspectives, the communications among the experts were spirited and productive, and the recommendations reflect the high quality of the debate. The reports also acknowledge instances in which task force members disagreed.

While each task force report provides detailed background information and recommendations specific to the topic, the reports share several common themes:

1. To pursue the ambitious agenda outlined by President Obama as a candidate, the Secretary must reinvigorate HUD culturally, moving it from an organization that has become mostly regulatory to one that brings thought, leadership, and flexibility to tackling the affordable housing needs of the nation and the broader issues of development in cities and metropolitan areas. HUD must lead by example, greening the nation's housing stock, developing innovative approaches to reduce carbon emissions, and becoming a model steward of vacant property.
2. The Secretary needs to put the “UD” back in HUD. HUD has become almost entirely focused on affordable housing. Without diluting that focus, HUD also needs to reinvigorate a second agenda – helping to shape the development of our cities and metropolitan areas through strategic investments and approaches that encourage regional thinking and action. For example, HUD's policies must allow for the flexibility necessary to develop neighborhood-appropriate stabilization strategies attuned to local market conditions, working to attract people and investment to areas that need strengthening and mitigate the effects of rising rents and home prices on low- and moderate-income people in neighborhoods where markets are hot. This kind of market-savvy flexibility is important if HUD is going to succeed at partnering at the local, regional, and state level as an urban development agency.
3. HUD also has a new opportunity to reclaim some mandates that have been lost to other agencies over the years. It should reclaim these mandates not out of some desire for bureaucratic turf, but because HUD's unique mission, to improve our cities and metropolitan areas, must be incorporated into the federal policy making process. HUD's role as a champion of homes and communities, for example, is critical to devising the federal strategy to prevent foreclosures and assist communities already devastated by foreclosures.
4. HUD needs to work creatively with other agencies to combine HUD's place-focus with the people-focus of the Department of Education (DOE), Health and Human Services (HHS), Veterans Affairs (VA), and other agencies. To respond to issues of persistent poverty, entrenched racial and economic segregation, and to address the range of causes of homelessness, for example, the federal government must thoughtfully invest in both people and places. An inter-agency approach will ensure that this investment is coordinated and complementary.

5. HUD cannot go it alone. HUD's reach will be vastly greater if HUD relearns how to partner with businesses, community groups, local and state governments, and anchor institutions to reinvigorate cities and metropolitan areas. A central theme of the Obama campaign was that the federal government cannot solve all of our problems – but that it can work with other stakeholders within communities to allow us to solve our own problems. This maxim is particularly true in the context of economic development.
6. HUD's research, data, and analytic capacity has stagnated in the last eight years. It is crucial for HUD to support fuller data systems and to issue regular reports on its own programs as well as the conditions in cities and metropolitan areas. HUD's research on trends and promising approaches to tackling long-standing problems is an important way to catalyze the adoption of best practices by HUD's partners in and out of government.

These six themes are reflected in virtually all of the reports from the ten task forces.

The reports are organized into three Parts, each addressing critical HUD priorities: providing and preserving housing and housing markets; reinvigorating places – neighborhoods, cities, suburbs, and metropolitan areas; and, finally, building HUD's capacity and developing new initiatives.

PART 1: Preserving and Providing Housing and Housing Markets

This Part sets forth comprehensive strategies to help HUD confront the challenges the agency currently faces in its historical role as a champion of housing – and particularly affordable housing. This Part includes reports on how HUD might prevent future mortgage foreclosures, on how HUD can best provide multi-family housing, and on how HUD should respond to the challenges of housing the “hard to house.”

Preventing Foreclosures, authored by Bart Harvey and Barry Zigas, provides a brilliant analysis of the precise nature of the foreclosure crisis and a wide array of policy options to resolve the crisis. This team contends that HUD can and should play a central role in resolving the foreclosure crisis through direct action, using tools and authorities it already has; through new initiatives that it can lead; and through leadership across the government. Most centrally, this report proposes: that HUD should work to ensure that most owner-occupied housing, including where owners are currently paying their mortgages, are eligible for loan modifications or refinancing to take advantage of lower interest rates and escape from onerous reset triggers (either through the Treasury's implementation of the Federal Deposit Insurance Corporation [FDIC] loan modification plan or through Federal Housing Administration [FHA] credit enhancement); that HUD should support legislation permitting first lien mortgage loans to be subject to judicial modification in a bankruptcy proceeding; and that, for those instances in which investors fail to agree to reasonable modifications, the government should purchase mortgage assets through the Treasury, the Fed, government-sponsored enterprises (GSEs), or some combination of the three.

Taken together, these strategies present the possibility of helping every current household that is able and willing to pay a fair amount in their home. Along with a series of other direct actions by HUD, the effect of this report's recommendations would be to stabilize housing prices, restore consumer confidence, revalue and liquefy “toxic assets” that remain outstanding, and help replace fear with hope in the credit markets.

In *Improving Multi-Family Housing Production and Preservation*, Charles Werhane and his team describe a set of mortgage programs that are inherently well-designed but that need improvements in execution so that the multi-family mortgage programs can play a fuller role in creating more rental housing in the nation. This report also urges the Secretary to work with Treasury to strengthen the Low Income Housing Tax Credit program, one of the most successful housing programs in the history of federal housing programs. This report contains a long list of specific recommendations that if implemented will lead to greater efficiency and productivity in the provision of multi-family housing

The “Hard to House”, by a team led by Rosanne Haggerty, urges that HUD build from work that has succeeded in New York City and elsewhere to provide housing in good settings for people that are particularly hard to house: those with poor rental histories, homeless persons, those with chronic health, mental health or other disabilities, chronic substance abusers, the formerly incarcerated, the frail elderly, disabled veterans, persons living with AIDS, and transitioning youth. This report lays out a clear set of principles and innovative programmatic approaches that HUD

should take in cooperation with HHS, VA, and other agencies to match needed supportive services to the housing needed by these individuals and households.

PART 2: Reinvigorating Places – Neighborhoods, Cities, Suburbs, and Metropolitan Areas:

These reports address HUD’s potential as a catalyst for economic revitalization and community improvement. This role has long been a stated part of HUD’s statutory mandate but has yet to be fully realized.

Dan Kildee and his equally impressive team tackle an immediate issue in *Improving Communities Impacted by Foreclosure* – the devastating effect concentrations of foreclosures are having on many communities. In order to increase the effectiveness of the Neighborhood Stabilization Program (NSP), this detailed and thorough report recommends a series of steps, ranging from recommendations for rule changes to proposals for additional funding to make the NSP a more powerful tool for revitalization. In addition, to foster neighborhood recovery, it recommends a series of additional tools, ranging from FHA mortgage products to strategies to leverage public and private financing and enhance state housing finance agency capabilities and to more comprehensively foster neighborhood recovery. It also contends that HUD – as a significant owner and seller of foreclosed real estate owned (REO) property – should lead by example and commit to a “Code of Conduct”. HUD can also play a critical role by developing a database of foreclosed properties and incentivizing recording reform by states.

To protect the housing market and to prevent blight, HUD needs to ensure that its partners, particularly state and local governments and important private entities, are poised to take certain actions. Among these are responding to the excess supply of properties resulting from foreclosures – this can most effectively occur by building local capacity to design and implement land banking activities, with particular focus on inter-jurisdictional cooperation, and by reforming certain counterproductive state and local tax and mortgage foreclosure procedures. Finally, HUD has an important role to play in changing the redevelopment environment by building strong public-private partnerships and rebalancing housing supply and demand in distressed neighborhoods.

In the report addressing HUD’s role in *Strengthening America’s Neighborhoods*, Wendell Pritchett and his team build from years of work by community groups, local governments, and private foundations to strengthen America’s neighborhoods. They make an important contribution by urging HUD to recognize the importance of markets as it develops economic development strategies. This insight lead them to recommend that HUD significantly alter the Community Development Block Grant (CDBG) program to allow these funds to be used differently for neighborhood improvement, depending on market conditions – so that weak-market neighborhoods and strong-market neighborhoods could use CDBG and other HUD funds more flexibly in order to better meet the very distinct challenges these neighborhoods present. This group also recommends that HUD play a supportive role in comprehensive neighborhood improvement programs such as Promise Neighborhoods.

In the report entitled *New Strategies for a Metropolitan America: Extending HUD’s Urban and Regional Mission*, Harold Wolman and his team make a compelling case that HUD lead the federal government to embrace regional approaches to a host of important metropolitan issues including the link between housing and labor, transportation systems, pollution and environmental concerns, and general economic prosperity. This report by many of the nation’s leading thinkers on regionalism sets forth concrete steps for HUD to engage local governments, other federal agencies, and local stakeholders in regional efforts. The report recommends several specified internal fixes which will allow HUD to publicly affirm the centrality of regional approaches. Among other innovative programmatic changes, the report recommends that HUD: propose new legislation that would create a “Regional Challenge Grant,” a multi-year competitive grant program for proposals designed to have a regionally significant impact; propose legislation that would modify CDBG (and possibly the Home Investment Partnerships Program [HOME]) to provide incentives for regional activity and, at the same time, to encourage and strengthen regional governance processes; and submit legislation to provide general operating funds (“glue money”) for a designated multi-purpose planning agency in metropolitan areas.

In *A City-Focused Economic Development Agenda for the Federal Government and HUD*, team leader Edward (Ned) Hill and Fran Stewart set forth a renewed vision of HUD’s role in promoting economic development investment for cities – defined in the report as efforts designed to facilitate the creation of goods and services, to make areas more

economically competitive and viable, and to improve the income and job prospects of individuals. In other words, the authors' argue that HUD should restore the urban development (the "UD") function to its core mission. The paper recognizes the challenges HUD will have to overcome to play this role effectively and identifies six areas where HUD can have the greatest impact in supporting the economic redevelopment of the nation's urban core – many of which are addressed in detail in other reports: promoting green cities by investing in alternative energy technologies and increased recreational space; responding to the devastation of the foreclosure crisis by launching land-banking initiatives; reshaping cities around anchor institutions and anchor amenities; restructuring the Community Development Block Grant program to support economic development; and providing the capacity for fundamentally restructuring the public finances of failing cities. The strength of this report is that it lays out a persuasive rationale for HUD's role in areas other than housing.

Anchor Institutions as Partners in Building Successful Communities and Local Economies, the report produced by the team led by Ira Harkavy, recognizes that colleges, universities, medical centers, and other local anchor institutions are increasingly important to local economies. HUD once was active in supporting community partnerships to tap the potential of these institutions, and this task force lays out a detailed, aggressive set of programs, based on sound partnership principles, for HUD to help local anchors play a more assertive role.

PART 3: Building HUD's Capacity and Developing New Initiatives:

These reports concern the culture of HUD and its internal capacity to achieve the ambitious agenda envisioned by Congress and promised by the Obama campaign as well as the new goals of energy efficiency and environmental sustainability made all too crucial by the confluence of our energy crisis, global warming, and our economy.

Facilitating Green Housing, a pace-setting report authored by Anne Evens and John Cleveland, presents a major new initiative for HUD – making the inventory of housing it controls more energy efficient, while also leading the way to the development of a new green housing industry that will encourage owners to make the privately owned housing in this country greener. This initiative is sound from an energy and environmental perspective but also has potential for a tremendous economic impact. A direct HUD investment of \$25.7 billion would leverage an additional \$29.7 billion, for a total investment in the housing retrofit market of \$55.4 billion. A total of 590,700 direct jobs would be created. A total of 1.5 million indirect jobs would be created. HUD would save an estimated \$206 million per year in direct energy. This report presents a comprehensive set of recommendations to achieve a central campaign promise.

Accomplishing the goals set forth in these nine reports – as well as the other agency initiatives these reports do not address – is a massive undertaking. Accordingly, the final report, *Catalyzing Change at HUD*, authored by Jeffrey Lubell and Pete Plastrick, addresses the internal agency culture. The report sets forth: the core principles for "catalytic government" – a framework for open, enabling, strategic, results-oriented government which are applied to develop recommendations for how HUD could become more effective; recommendations for action in the short- (within 90 to 180 days) and medium- (within first year) terms; and leadership requirements for transforming HUD. The report aims to provide a case and initial agenda for *organizational* transformation of HUD which is premised upon the Secretary's personal, visible, and sustained leadership.

Overall, these task forces present a robust agenda for HUD. The task force leaders are mindful some of the changes recommended here will take time to effect, while others can be implemented quite quickly. The reports are presented with great hopefulness that, with new leadership and an improved framing of its mission, HUD can play a leadership role in achieving the 1949 national goal of "a decent home and a suitable living environment" for all Americans.

Paul C. Brophy
Project Director

Rachel D. Godsil
Project Director

**PART 1:
PROVIDING and PRESERVING
HOUSING and HOUSING MARKETS**



RETOOLING HUD

for a CATALYTIC FEDERAL GOVERNMENT:
a REPORT to SECRETARY SHAUN DONOVAN

Penn Institute for Urban Research
University of Pennsylvania

CHAPTER 1

PREVENTING FORECLOSURES

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

EXECUTIVE SUMMARY

Since 2007, more than 2 million families have lost their homes and Credit Suisse recently projected that more than 8 million more will do so over the next four years. These losses have been a major contributing factor in the economy's decline. Foreclosures have decimated homeowners' equity and economic security. Values of homes across the country have plunged under the pressure of foreclosures. In some communities, the concentration of foreclosed homes has reversed years of public and private reinvestment and replaced thriving communities with blocks of abandoned homes. The U.S. Department of Housing and Urban Development (HUD) can and should play a central role in resolving the foreclosure crisis. It can do so through direct action using tools and authorities it already has; through new initiatives that it can lead; and through leadership across the government.

Over the past two years, the mortgage servicing industry, Congress, and the Administration have all promoted voluntary attempts to address the foreclosure crisis. These initiatives have included the creation of the Hope Now Alliance; encouragement to servicers and investors to allow and promote individual modifications of existing loans to cure delinquencies and forestall defaults; streamlined and standardized modification efforts like those promoted by the Federal Deposit Insurance Corporation (FDIC) and the Federal Housing Finance Agency (FHFA); and new Federal Housing Administration (FHA) programs like Hope For Homeowners and FHA Secure. Yet, the overall impact of these efforts has been very modest. The FHA Hope for Homeowners program has foundered badly.¹ Voluntary and individual modification efforts are time consuming and, according to the Office of Comptroller of the Currency (OCC), often lead to redefaults.

Clearly, more aggressive action is necessary to make significant impact, and only an extremely coordinated, comprehensive effort of complementary parts will begin to stabilize housing prices, restore consumer confidence, revalue and liquefy "toxic assets" that remain outstanding, and help replace fear with hope in the credit markets. Both the pace of defaults and consensus estimates of further house price declines have risen since the fourth quarter of 2008. These higher forecasts increase the urgency of action. They also argue for significantly larger and more dramatic interventions than might have been assumed only months ago.

Our recommendations stress the most cost-effective means of making a big impact, keeping people in their homes, stabilizing home prices, offering stimulative fiscal relief to beleaguered homeowners, and restoring stability to the housing market. We support different approaches to resolving the dilemmas facing performing borrowers and those facing borrowers who already are in delinquency or default. We believe that the moral hazards of helping delinquent borrowers and thereby encouraging performing borrowers to become delinquent in order to receive consideration and relief can be mitigated through a market-driven refinancing opportunity for performing borrowers and strategic use of FHA and Troubled Assets Relief Program (TARP) resources.

We set forth our recommendations below, outline a range of other possibilities, and attach some further information as Appendices. Whatever the final menu, it should be fair, bold, and aggressive and help borrowers stay in their homes; help improve consumer sentiment; and help reliquefy the mortgage market. Actions that create effective modifications or enable performing borrowers whose loans are in private label securities to refinance will help reset the values of the securities, which could provide important capital relief to the banks and others now holding these at deeply discounted mark to market values.

¹ "Rep. Frank, Administration Battle Over Housing Blame," *The Hill*, December 22, 2008

We are operating under the following strategic premises: first, any plan should serve principally owner-occupied housing; second, cases of gross fraud would be ineligible, as well as those cases where income is insufficient to carry any mortgage; as should mortgages where the modified loan-to-value ratio exceeds 120 percent or a net present value calculation makes the proposed solution impractical.

However, all other owner-occupied housing, including where owners are currently paying their mortgages, should be eligible for loan modifications or refinancing to take advantage of lower interest rates and to enable borrowers to escape from onerous reset triggers. Not all performing borrowers will be eligible for the opportunities we propose, but a significant number will be, with broad economic and social benefits. Furthermore, first lien mortgage loans should be subject to judicial modification in a bankruptcy proceeding under our recommendations. Taken together, these strategies present the possibility of helping every current household that is able and willing to pay a fair amount for their home.

While HUD does not have direct jurisdiction to implement all the components we think necessary to avert the worst of the foreclosure crisis, the Secretary will of course be a key player in determining the Administration's response to the crisis. Accordingly, we set forth the full plan below and distinguish between those recommendations in which HUD would be the lead agency and those in which the Secretary's role would be to advocate for the adoption of a recommendation.

The full report contains a series of related recommendations that together form a coherent and comprehensive approach to the current crisis. In this section we highlight only the four most significant of these linked recommendations.

Recommendation: The HUD Secretary should support the direct purchase of delinquent and defaulted mortgage loans held in private label securities (PLS) through the Treasury, the Federal Reserve Bank (the Fed), the government-sponsored enterprises (GSEs) or some combination of these.

The rapidly deteriorating forecasts of house price declines, mortgage delinquencies and borrower failure rates convinces us that dramatic action is necessary to create the widespread and effective modifications needed to save borrowers and their homes. We strongly believe that the most efficient and cost-effective way to manage these loans is for the federal government to purchase them at a discount on an all-or-nothing portfolio basis and then apply sweeping modification strategies with a view to holding the loans for as long as necessary to bring them current or to recover their maximum realizable value. Only this approach will create significant, widespread modifications at the scale and on the pace necessary to arrest this rapidly deteriorating situation.

TARP originally was promoted as a means to this end in order to permit the modification and restructuring of the loans. Acquisition of the mortgage loans would eliminate the complications of the bond structures. Government would become the new asset owner and have the same scope of action for modifications available to lenders holding mortgages in their own portfolios.

There are some legal and accounting issues that would have to be resolved in order to make these purchases necessary and these are detailed in the text.

Recommendation: If the purchase strategy cannot be pursued, or in the event some investors decline to sell to the government, the Secretary should urge Treasury to implement the streamlined loan modification plan proposed by the FDIC and authorized by TARP, whereby the government would pay an administrative fee to servicers and guarantee 50 percent of the outstanding balance if sustainable loan modifications made following the plan's protocols fall into default again.² FDIC estimates that their plan could reduce foreclosures by one-third. We believe that any financial institution that accepted TARP funding should be mandated or, at a minimum "strongly encouraged" to participate as a condition of the TARP funds.

We also recommend a series of related strategies and policy changes to facilitate modifications by addressing obstacles that have proven to be troublesome to date, including compensation for servicers, protection from legal liabilities, and changes to the conditions governing Real Estate Mortgage Investment Conduit (REMIC) tax treatment.

² Details of the plan can be found at <http://www.fdic.gov/consumers/loans/loanmod/index.html>

Recommendation: HUD should provide an FHA credit enhancement backed by an allocation of TARP or other appropriated funds to enable borrowers whose loans are held in PLS and who are currently paying their mortgages but are underwater because of house price declines to refinance their homes by guaranteeing the principal up to 120 percent of a current appraisal.

Borrowers with mortgage debts totaling roughly \$1 trillion held in private label securities are current in their payments, but an estimated 41 percent are unable today to refinance into lower rates or more stable mortgages because their property is “upside down.” This 41 percent is estimated to increase to 62 percent over the next two years. Other modification plans assist only delinquent borrowers, leaving these performing borrowers with no avenues through which to reduce their payments or escape burdensome terms. This insurance would enable them to benefit by refinancing their loans to gain the advantage of lower monthly payments. The insurance would cover a maximum of 40 percent of the outstanding balance if a currently performing borrower defaulted.

On the investor side, this credit enhancement would help re-stabilize prices for securities backed by these performing loans and provide capital relief for the institutions holding them at mark-to-market values that are currently lower. Finally, the run off of performing loans out of these private label securities spurred by insured refinancings may prove to be a powerful incentive for investors to authorize servicers to more aggressively modify nonperforming loans to shore up their value as the net present value (NPV) valuations of the shrinking pools shift.

Eligible borrowers should have at least 12 consecutive current payments on their loan; have a new loan balance not greater than the FHA loan limit; have no outstanding late payments on any other credit lines; and agree to automatic payment of the new loan amount through a draft on their checking accounts. No cash-out refis would be permitted. The borrower would be required to pay a fee for this new coverage,

We believe that this refinancing could be accomplished on a streamlined basis with low costs to consumers and lenders compared to other alternatives, and could take advantage of the core competencies of current servicers and Fannie Mae and Freddie Mac, which we elaborate in the text.

The take out of performing and nonperforming loans from PLS should be linked to the greatest extent possible, as the advantage to the trust of the former counteracts the possible disadvantage of the latter. Given deteriorating economic circumstances, and the high rates of defaults possible because of income reductions and other credit burdens, modifications without sale of the performing loans may yield negative NPV results, whereas a comprehensive approach that includes refinancing of the performing loans always will result in a positive NPV for the trust’s loans as a whole, and as well limits adverse selection.

Recommendation: The HUD Secretary should support legislation permitting judicial modification of mortgages in Chapter 13 bankruptcy.

Another effective way to break through the barriers put up by servicers and investors to effective and fair modifications is to empower a court to implement an economically rational solution where the parties cannot do so on their own. This would solve the servicers’ fear of investor lawsuits (no liability can arise from compliance with a court order), would solve servicers’ financial incentives and lack of qualified staff, and would solve the problem of junior lien holders, whose cooperation can be compelled by the court. This is what bankruptcy courts do every day, for all manner of debts, except for the mortgage on the primary residence.

Bankruptcy is not a solution of first resort. But if all other efforts by borrowers, government agencies and others fail, then consumers should have the right to the full protection of a bankruptcy court as an ultimate recourse. Simply knowing that a loan could be restructured by a bankruptcy court if the borrower and servicer/investor cannot find an equitable accommodation earlier likely will change the servicers’ and investors’ cost-benefit analysis in ways that could favor more aggressive efforts to modify loans.

Recommendation: The HUD Secretary should support legislative changes to the tax treatment of REMICs to facilitate asset sales and modifications.

Congress should pass legislation permitting government purchase of loans under REMIC tax rules and providing that continued REMIC tax-free status is contingent on pooling and servicing agreements (PSAs) being modified to permit

(but not require) participation in this process.³ In addition, Congress, the Securities and Exchange Commission (SEC) or Financial Accounting Standards Board (FASB) would need to ensure that accounting standards change to permit these sales. The current application of Financial Accounting Standards No. 140 (FAS 140) appears to be a significant obstacle to the sale of mortgage assets out of these trusts, but one that could be remedied fairly easily through the FASB and SEC.

Congressional adoption of the REMIC pass-through changes recommended above also would provide an important incentive for investors, servicers and trustees to cooperate in any government sponsored purchase plan.

HUD's Role

We believe that HUD can and should play a major role in addressing this problem.

- First and foremost, HUD must reclaim its role as champion of American homeowners and their communities. No other federal agency has a comparable chest of complementary tools to support comprehensive community focused plans for recovery, or the experience and tools in credit enhancement, mortgage underwriting, and asset management that FHA does.
- HUD immediately should ensure that it is facilitating loan modifications within its own FHA portfolio. Current rules require servicers to buy FHA-insured loans out of Ginnie Mae pools before any modifications can be made, and FHA will not honor full or partial claims that might otherwise result if the loan is not put into foreclosure. This makes FHA a significantly less flexible partner than many private portfolio lenders or private mortgage insurers. Given the rapid increase in FHA's market share since 2006, and the subsequent increase in troubled loans in its portfolio, rectifying this problem should be a very high priority. A solution would be to allow partial claims on a modification, repaying the net present value difference between the new loan vs. the unpaid balance of the old loan, since the servicer will only be able to sell the new loan at a discount to the original UPB if the modification actually reduces the borrowers' obligation, rather than simply extending arrearages.
- FHA can provide credit guarantees on newly modified conventional loans as a means of increasing servicers' willingness to carry out modifications.
- FHA can provide new forms of credit enhancement to facilitate the refinancing by private lenders of more than \$1 trillion in mortgage debt that is currently performing but where the mortgaged properties are underwater because of falling property values. Effective action to enable performing borrowers to take advantage of historically low interest rates would greatly increase these borrowers' likelihood of success as well as provide significant stimulative relief through an immediate lowering of interest payments.
- FHA should examine ways to work through Fannie and Freddie in carrying out various options outlined above to enable the capacity needed to expedite these initiatives.

³ See Center for American Progress, Issue Brief: Overcoming Legal Barriers to the Bulk Sale of At-Risk Mortgages, April 2008, available at http://www.americanprogress.org/issues/2008/04/reimc_brief.html.

INTRODUCTION

Millions of Americans have already lost their homes through foreclosures. These losses have been a major contributing factor in the economy's decline. Foreclosures have decimated homeowners' equity and economic security. Values of homes across the country have plunged under the pressure of foreclosures. In some communities, the concentration of foreclosed homes has reversed years of public and private reinvestment and replaced thriving communities with blocks of abandoned homes. HUD can and should play a central role in resolving the foreclosure crisis. It can do so through direct action using tools and authorities it already has; through new initiatives that it can lead; and through leadership across the government.

Since 2007, more than 2 million families have lost their homes. Credit Suisse recently projected that more than 8 million will do so over the next four years.⁴ While losses to date have staggered the economy, reliable estimates project that significantly higher losses are on the way in 2009 and 2010 because of a combination of factors. At first these losses were the result of poorly underwritten loans and overextended consumers. Now, as the housing and credit debacle extends into the "real" economy, more and more owners are missing mortgage payments and risking foreclosure because of job losses or declining incomes as a result of shorter hours and reduced pay. The Hope Now Alliance recently reported that 42 percent of the calls received on their hotline in 3Q08 were from owners under pressure because of a job loss.⁵ While this figure is not necessarily from a representative sample, or evidence of an acceleration in this segment, it signals that the market is now straining under a toxic mix of underwater and unaffordable mortgages combined with increased economic strains through job losses or declining incomes.

To add to this nearly perfect storm, millions of so-called Alt-A loans with option payment plans and other features are moving into the years with the highest projected losses. Payments on nearly one-half of the \$200 billion in outstanding payment option adjustable-rate mortgages (ARMs) tracked by Fitch Ratings will jump nearly 63 percent in the next two years, for instance.⁶

Older Americans, who are more likely to be living on fixed incomes and have less economic resiliency, comprise a significant share of those facing mortgage difficulties. A recent study by the American Association of Retired Persons (AARP) estimates that "...Americans age 50 and over represent about 28 percent of all delinquencies (30 to 180 days late) and foreclosures..." and that "Over 684,000 older Americans (age 50 or older) were either delinquent or in foreclosure at the end of 2007."⁷

As the task force focusing on mitigating the effects of the foreclosure crisis delineates in greater detail, foreclosures have had a devastating effect on home prices. Nationally, prices have declined an average of 7-9 percent in 2008 and Fannie Mae projected in their 3Q08 10-Q filing with the SEC that the "peak-to-trough" decline will be in the 15-19 percent range before prices stabilize.⁸ The Case-Schiller index, based on a sample of about 20 cities, estimates a decline nationally of 15-16 percent 2008 and 27-32 percent peak-to-trough.⁹ These projections have been worsening since the start of 2009. This swing from one extreme to the other is reducing consumer confidence; preventing families from taking advantage of historically low interest rates through refinancing because their homes are now appraised at less than their mortgage balances; preventing new homebuyers from entering the market due to fear of future declines; and choking off spending and credit at a time when the economy is faltering.

Millions of renters also face eviction and possible homelessness because of the mortgage crisis. While Fannie Mae and others recently have amended their policies to permit renters who are not delinquent in their rent to remain in homes after a foreclosure, this is not a universal policy. As a result, millions of renters also are exposed to eviction and

⁴ "Foreclosure Update, More than 8 Million Foreclosures Expected," Fixed Income Research, Credit Suisse, <http://www.credit-suisse.com/researchandanalytics>, December 4, 2008

⁵ Ms. Colleen Hernandez, President, Home Ownership Preservation Foundation, in December 22, 2008 conference call to announce Hope Now Alliance's year end results.

⁶ "Option ARMs: It's Later Than It Seems," Fitch Ratings, Structured Finance Residential Mortgage Special Report, September 2, 2008, www.fitchratings.com. "The potential average payment increase on this recasting population is 63 percent, representing on average an additional \$1,053 due each month on top of the current average payment of \$1,672. Data suggest that these large payment increases could cause delinquencies to more than double after recast." These payment increases result primarily from amortization over 25 years as principal repayment requirements kick in.

⁷ *A First Look at Older Americans and the Mortgage Crisis*, Insight on the Issues 9, AARP Public Policy Institute, September, 2008

⁸ Form 10-Q, Federal National Mortgage Association, for the quarterly period ending September 30, 2008, p. 8

⁹ Ibid

homelessness as a result of the mortgage crisis. This devastating blow comes at a time of a critical shortage of affordable rental housing as well as continuing declines in new production and preservation of such homes. While this problem is outside the scope of this paper, it is a critical problem in many communities. HUD could play a major role in addressing it through vouchers, FHA insurance and Neighborhood Stabilization funds.

Every month that goes by brings more and more pessimistic forecasts of sinking home values and mortgage delinquencies and defaults. This trend increases the need for urgent, dramatic and comprehensive action.

A. Taking into Account the Diverse Nature of the Problem

The development and rapid growth of sophisticated capital market funding designs in the early part of this decade have contributed to the complexity of resolving this crisis. Home mortgages today can be divided into three rough categories, based on the ultimate investor in the mortgage:

1. *Loans held in bank and thrift portfolios.* This category is estimated to include roughly 27 percent of all mortgage debt outstanding and about 10 percent of all loans 90 or more days delinquent. Because they have an undivided interest in the mortgages, these holders have broad freedom to design and execute mortgage modifications. They also have a direct financial interest in avoiding foreclosure and the subsequent hit against their capital. Because they own these loans, these holders can more quickly identify potential solutions and have the discretion to adopt a wide range of solutions, including principal reduction and streamlined refinances. However, modifications may require the banks to write down the value of the assets immediately, which is a disincentive to modification.
2. *Loans held or controlled by Fannie Mae and Freddie Mac.* The GSEs hold or guarantee securities backed by roughly 51 percent of total single family mortgage debt in the U.S., and account for about 17 percent of all delinquent mortgage debt. The two companies are currently in conservatorship and, with the initiation of the U.S. Treasury's intervention in September, 2008, they are effectively owned by the U.S. Government. These radical changes to their ownership and management make them potentially powerful tools to address the mortgage crisis.
3. *Loans in private label securities.* An estimated 80 percent of all loans originated as subprime or through Alt-A terms were sold into private securitization trusts. These loans together make up about 16 percent of all outstanding mortgage debt, but since they comprise 58 percent of all serious delinquencies (SDQs), they are driving the foreclosure crisis. Resets on payment option adjustable rate mortgages and interest only loans are fast approaching, as noted above. PLS loans have proven to be the most difficult to address because of the obstacles noted above. Resolution of these loans also has been complicated by recent litigation, *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v Countrywide et al.*, that seeks to require repurchases of whole loans out of mortgage pools before modifications are made.¹⁰

The loans themselves can be further classified into several groups:

1. First lien loans
 - a. To owner-occupants
 - b. To investors who acquired them in order to rent the units
 - c. To investors speculating in real estate
2. Second liens
 - a. To owner-occupants
 - b. To investor owners

¹⁰ Mortgage debt outstanding includes non-government first liens. Delinquencies include conventional conforming first liens. Jumbos account for an additional 2.7 percent of SDQs and Government insured loans account for 11.7 percent of the SDQ loans. Source for mortgage debt outstanding is Global Economics Paper No. 177, *Home Prices and Credit Losses*, Goldman Sachs Global ECS Research, January 13, 2009. Source for SDQ rates is industry interviews. These data are all from the latter quarters of 2008. Since then, new forecasts have shown steady deterioration in the outlook for all of these critical indicators.

B. Voluntary Efforts Have Not Stemmed the Tide

Over the past two years, the mortgage servicing industry, Congress, and the Administration have all promoted voluntary attempts to address the foreclosure crisis. These initiatives have included the creation of the Hope Now Alliance; encouragement to servicers and investors to allow and promote individual modifications of existing loans to cure delinquencies and forestall defaults; streamlined and standardized modification efforts like those promoted by the FDIC and the FHFA; and new FHA programs like Hope For Homeowners and FHA Secure. Yet the overall impact of these efforts has been very modest. The FHA Hope for Homeowners program has foundered badly.¹¹ Voluntary and individual modification efforts are time-consuming, and there is strong evidence that modification plans that do not reduce borrowers' monthly obligations are much more likely to suffer additional delinquencies and possible re-defaults than those that do so.

The reasons that voluntary modifications have failed are the lack of trained servicing staff to respond to the increased demand, the presence of second liens that complicate modification of the first mortgage, as well as the additional issues associated with securitization: contractual limitations imposed by investors on servicers' modification actions; servicer financial incentives to foreclose rather than modify; investor requirements for servicers to use loss-mitigation approaches that result in the highest NPV for the investor, without providing standardized means for determining this; tax and accounting restrictions; the fact that some trusts require consent of a supermajority of each class of investors to agree to amending contract terms.¹² Most disappointing, the Treasury Department has not used its TARP in a comprehensive way that will reduce foreclosures. Nor has the Treasury used the authority granted it by Congress to promote loan modifications using a guarantee program.

BROAD RECOMMENDATIONS

The steadily deteriorating state of the economy, house prices, and mortgage performance, coupled with the increasing documentation of very high non-housing debt loads that make successful mortgage loan modifications increasingly difficult to engineer argue for a dramatic and bold intervention by the federal government to directly purchase nonperforming mortgage loans in order to gain control of them to structure effective modifications for current borrowers with an expectation of long-term asset holding in order to facilitate the kinds of modifications that may be necessary.

Recommendation 1: Using the Treasury, the Fed, the GSEs or some combination of the three, the government should offer to purchase nonperforming loans held in private label securities at a set discount.

This price should be slightly higher than current marked-to-market estimates in order to incent sales, and should require investors to sell all such loans in order to be eligible for the program. Upon acquisition of these loans, the government can sort through them and create modified payment plans that will offer maximum flexibility to enable borrowers to stay in their homes.

We believe this approach offers the greatest chance of staunching the flood of delinquencies and foreclosures that are helping to drive the current economic crisis. It gives the government control over the loans. As a long-term investor/holder, the government can undertake modifications on far more flexible terms than any private servicer or investor. And as the economy improves and borrowers' ability to repay debts increases, the government will be able to recoup a sizeable share of its initial outlay.

It also is critical to adopt policies to increase the utility and take up rates of private mortgage modification plans. Modifications can successfully avert foreclosures and the borrower's loss of a home. They can result in lower economic loss to the investor and lender than default and foreclosure. Through proper design, modification plans can ultimately give the investor a stake in the owner's future success through the use of Shared Equity provisions. By reducing the flow of foreclosed properties into neighborhoods, the free fall of housing prices can be slowed or arrested.

¹¹ "Rep. Frank, Administration Battle Over Housing Blame," *The Hill*, December 22, 2008

¹² See <http://www.federalreserve.gov/pubs/feds/2008/200846/revision/200846pap.pdf> for a good discussion on servicer incentives. Resolution of securitized loans also has been complicated by recent litigation, *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v Countrywide et al*, that seeks to require repurchases of whole loans out of mortgage pools before modifications are made.

A combination of related and complementary policy tools are needed to have large scale impact. These approaches are outlined in three basic areas: changing servicer incentives to encourage more loan modifications, creating standards for what constitutes a sustainable and fair loan modification, and eliminating legal barriers to effective modification.

However, should the government not choose to buy nonperforming loans, it should aggressively set a program of loan-modification based upon the principles outlined below and tie its offer with a refinancing of performing loans also offered below.

Recommendation 2: Change servicer incentives to encourage more loan modifications.

Currently, servicers have few incentives to make loan modifications instead of foreclosing on a loan. HUD should take the lead in encouraging the federal government to take a multi-pronged approach to incentivize loan modification. First, the government should guarantee loan modifications that meet prescribed standards for loan modification measures and decision rules and pay an administrative fee to servicers for costs involved in sustainable modifications. These two approaches should be the first step tried – with the government actively working with servicers and investors in all three of the types of loans mentioned above, loans held in portfolio, loans controlled by Fannie Mae and Freddie Mac, and loans in private label securities – to use these approaches to encourage voluntary modifications on a large scale. Assuming good lender cooperation, one estimate is that these approaches have the potential to create approximately 2 million stable loan modifications over the next two years.

Finally, as an important parallel to the first two tracks that should be implemented immediately, Congress should modify Chapter 13 bankruptcy to permit judicial modification of mortgages. Bankruptcy provides an important last resort for homebuyers, in addition to changing the cost/benefit ratio for servicers in a way that will encourage voluntary loan modifications to occur.

Recommendation 3: Establish consistent standards for sustainable and fair loan modifications.

All loan modifications should proceed according to a prescribed set of loan modification measures and decision rules. These standards must be embedded in all relevant program regulations and legislation:

- Government incentives to servicers should be provided conditioned upon adherence to these standards
- In instances where the government acquires mortgages, or controls these mortgages in other ways (e.g. through FHFA conservatorship of the GSEs), these standards should also apply

Recommendation 4: Eliminate legal barriers to effective modification.

The final two recommendations provide important additional steps to make all of the above recommendations more possible. Currently, modifications can lead to severe tax consequences for both the homeowner and the investor. Homebuyers may have to pay taxes on what the Internal Revenue Service (IRS) characterizes as forgiven debt. Investors may be concerned about losing favorable pass-through REMIC tax status; more generally, the public benefits conferred by REMIC status have not produced sufficient public return in terms of resulting in modifications rather than foreclosures. As such, the Administration should work with Congress to modify two aspects of tax law and encourage more modifications.

Recommendation 5: Ameliorate tax consequences of modifications.

At present, when a servicer provides a homeowner with a loan modification containing a principal write-down (the type of write-down contemplated to occur under the FHA Hope for Homeowners program) or, in certain circumstances, a significant interest rate reduction, the IRS considers the homeowner to have received taxable cancellation of indebtedness income unless the mortgage debt is “qualified” under the terms of the Mortgage Forgiveness Debt Relief Act of 2007 or the homeowner is insolvent. In many instances, especially where the difference between the original loan amount and the current value of the house is large, the prospect of tax liability could discourage homeowners from seeking a modification, or, if such a modification is obtained, the resulting tax liability could cause the homeowner to default again on the new loan. To prevent this perverse result, Congress should amend the Mortgage Forgiveness Debt Relief Act of 2007 in two ways: (1) lenders should not be required to file a Form 1099 with the IRS when cancelling any mortgage-related debt; and (2) the definition of “qualified mortgage debt” should be extended to include all home equity debt.

Recommendation 6: Congress should make its favorable REMIC tax status contingent on changing the PSAs to remove artificial obstacles to modifications.

REMIC status should also require public reporting of modification activities.

OVERARCHING PRINCIPLES

We believe that first priority should be given to first-lien mortgages to owner-occupants. We also believe there is an important claim by innocent occupants of 1-4 unit rental properties whose homes are at risk because of investor defaults.

Some portion of troubled loans were originated or obtained through fraudulent or abusive lending practices. We strongly encourage aggressive enforcement against brokers, lenders and others who engaged in such practices. Federal Housing Finance Agency (FHFA) Director James Lockhart recently estimated that Fannie Mae and Freddie Mac will require lenders to buy back more than \$1 billion in fraudulent or ineligible loans in 2009.¹³ Other federal, state and local agencies should vigorously enforce their own and consumers' rights in such cases.

Within these groups there are further distinctions:

1. Owners who are current in their mortgages but unable to refinance into lower rates because they are "upside down" due to reduced home values
2. Owners who have missed some payments
3. Owners who have missed more than 3 payments
4. Owners who are in default

There are also different groups of approaches to the problem, which run along a continuum of modifications, starting with the current owners and moving through executive modifications to judicial modifications. These can roughly be defined as:

1. Acquisition of mortgage loans through some form of auction or negotiated purchase program in order to gain control of them to carry out modifications through a new owner, such as Treasury, HUD, a GSE or other investor.
2. Acquisition of mortgage loans using eminent domain authority to forestall damage to the overall economy and to reduce or stem blighting effects of concentrated foreclosures by acquiring the loans and modifying them.
3. Mortgage-by-mortgage modifications between servicers and borrowers that are tailored to the specific circumstances of the borrower and the specific terms of the investors.
4. Wholesale modifications applied to existing borrowers, much like that proposed by FDIC Chair Sheila Bair, or as adopted by the FHFA and Fannie Mae and Freddie Mac, as well as by various lender/servicers, such as Citimortgage, JP Morgan Chase and others. Under these systematic approaches, standard modification conditions, such as a 31 percent housing debt-to-income ratio, are applied to all owners, regardless of specific circumstances.
5. Judicial modification through bankruptcy proceedings.

Other difficult concerns include the following:

- Moral hazard that those that can pay will default in order to qualify for assistance.
- Adverse selection by borrowers or servicers/investors if offer is overly generous, e.g., servicers/investors will seek assistance only for those loans with the worst outlook, increasing the chances for redefault and lowering success rates overall, while leaving other homeowners with unreasonable burdens.
- Effect on the bank capital (e.g., if any scheme to purchase mortgage securities does so at a discount to their mark to market value, accounting rules may force a writedown of all such bonds, leading to potential further writedowns in bank capital).
- Early redemption of loans held in bank portfolios through an effective refinance option could cause these banks to have to lower the value of the servicing on these mortgages due to potential early run off of the loans. These banks also could experience reduced income as a result of the refinancings because of the lost servicing.

¹³ FHFA: 09 Buybacks Will Surpass \$1 Billion, *National Mortgage News*, December 15, 2008

This could be ameliorated somewhat if the same institutions added new loans to their books through the refinancings.

- Total cost of program to taxpayers — Outlays vs. value of collateral plus any value of upside potential if a silent lien or equity sharing of any appreciation is applied on taxpayers' behalf.
- Increasing the flexibility of trustees and reducing their fear of lawsuits.
- How to demonstrate that a modification maximizes net present value (as required in PSAs).
 - Legal threats to modifications.
 - Problem of “waterfall” where servicers first try to work out a repayment plan that minimizes economic loss to the investor. Interest and principal reductions are last resorts.
 - Difficulty of comparison to value of an unmodified loan, including calculating the value if foreclosed [consists of current market value (which generally is less than the mortgage amount), minus the cost of foreclosure minus cost of going through the REO process (includes time value of money and maintenance costs for period it takes to resell plus any cost of rehab)].
 - How to establish “standard industry practice” which is a defense to accusations by investors that trustee is not performing properly.
- How to deal with second liens when trying to refinance (can be ignored when doing a modification).
- How (or whether) to distinguish between investors who are speculators and those who are legitimate landlords.
- Loans that remain underwater (e.g., with silent lien) even after a modification so potentially more likely subsequently to go to foreclosure once a current default is cured.
- Potential for fraud in resell price in cases, for example, where there is equity sharing or where borrower misrepresents his/her income, etc.
- Increased purchase of homes through an easing in home price declines may be offset by decrease in demand by consumers for other products.

Interventions in the mortgage process should have one or more objectives. First, interventions should be aimed at keeping people in their homes by mitigating an undershooting of housing prices to a normalized trend line and forestalling the elimination of trillions of dollars of net worth and its effect on consumer confidence. Second, interventions should be aimed at helping to stimulate economic recovery. Third, interventions should aim at stabilizing and stimulating the housing market to eliminate potential “market overhang”, reach realistic numbers for pricing collateralized debt obligations (CDOs), and return investor confidence. Doing so will help the larger economy, since the multiplier effect in housing expenditures is estimated in the range of 10:1. It also will help rebuild home values broadly by re-establishing a market for homes that can bring prices more in line with historical, rather than bubble-era, trends.

ALTERNATIVE STEPS

There are a host of related and complementary steps and strategies laid out below that the government could take either to further incent servicers and investors to more aggressively pursue modifications or to acquire the mortgage loans themselves in order to gain control of them and carry out modifications directly. The latter path would involve significant outlays to acquire the mortgages and immediately raise issues of how deep a discount to pay for these loans. Establishing a current market price is very difficult, given their uncertain payment futures and the lack of any market to purchase them.

Another alternative would focus on using government resources to refinance distressed as well as performing mortgages using FHA insurance to take advantage of current historically low market rates on 30-year fixed rate loans. This path would expose the government to some significant risk if the loans re-default, depending on the risk sharing with the original issuer, or if the remaining balance is not recovered when the home is ultimately sold. It also would provide a full payoff of current balances to investors, raising potential concerns about “windfalls” for currently nonperforming loans.

However, such concerns about potential overpayments to current investors, or convictions that investors who financed unsustainable loans in the first place should be punished before loans are stabilized must be balanced against the urgent need to adopt a broad and effective strategy to stop the rising wave of foreclosures. Our primary focus is

finding effective solutions that will enable borrowers to stay in their homes and, where possible, lower their monthly costs so they can succeed over the long term. No solution is likely to satisfy every potential issue that this crisis has raised. We fall on the side of doing more rather than less. Trying to craft a solution that successfully balances each and every interest in each and every case will delay bold action and undercut the chance to succeed. We believe that the deteriorating economy demands quick action on a scale that will have a meaningful impact on consumers' ability to stay in their homes.

The table below lays out the various alternative approaches that could be adopted and summarizes the pros and cons of each approach. Specific recommendations are outlined in the following section.

CATEGORY	STRATEGY	PROS and CONS
<p>Servicer Ability To Modify Give PLS servicers the ability to modify loans without regard to legal restrictions in PLS contracts.</p>	<p>Expand Safe Harbors for Servicers Housing and Economic Recovery Act of 2008 (HERA) and Emergency Economic Stabilization Act (EESA) provide limited safe harbors for servicers by establishing guidelines that servicers can follow and be deemed to have acted in the best interest of investors. Expand safe harbors to provide more protection to servicers, such as broaden the guidance regarding “reasonably foreseeable default” and NPV calculations</p> <p>Enact Legislation Regarding Mods Remove obstacles to modifying Pooling and Servicing Agreements by conditioning favorable REMIC tax treatment on such changes, and provide authority for the government to indemnify servicers to do reasonable modifications.</p>	<p>Pros</p> <ul style="list-style-type: none"> • Gives PLS servicers ability to pursue loan modifications more efficiently • Standardize PLS loan mitigations <p>Cons</p> <ul style="list-style-type: none"> • With regard to new safe harbors, legislation overriding contractual terms may cause investors to lose faith in sanctity of financial contracts and reduce investor demand for all forms of securitization. This is less likely for changes to REMIC treatment. • In the case of safe harbors, could result in investor lawsuits, which will cost taxpayers and delay results. Lower likelihood for REMIC treatment changes
<p>Servicer Incentive to Modify Provide incentives for PLS servicers to modify loans within existing contractual framework</p>	<p>Guarantee Modified Loans Government would provide a partial guarantee in the event that modified loans re-default. A premium for the guarantee could be paid from a portion of new payments from the modified loan or the guarantee could be fully carried by the government. This would mitigate the need to factor in a re-default risk in calculating NPV.</p>	<p>Pros</p> <ul style="list-style-type: none"> • Government and taxpayer could receive a premium payment for guarantee. • Guarantee would enhance the NPV calculation of a modification for investors <p>Cons</p> <ul style="list-style-type: none"> • Relatively high rate of re-defaults so far suggest that overall losses would exceed premium income, if any. • Could be perceived as an investor bail out if principal amounts are not reduced.
	<p>Purchase Loans From PLS Trusts The Government would buy defaulted or delinquent loans from the trust. The purchase price could be based on the greater of NPV with a loan mod or foreclosure. Acquisition of the loan would enable the government to take a wide range of modification options.</p>	<p>Pros</p> <ul style="list-style-type: none"> • Investors receive highest NPV <p>Cons</p> <ul style="list-style-type: none"> • Congress must change REMIC law and change PSAs through maintaining REMIC status. May need FASB and SEC approval to sell loans out of the trusts. • Potentially higher cost to taxpayers than for other approaches
	<p>Eliminate NPV Shortfall For defaulted or delinquent loans, government makes up the shortfall to investors in any NPV calculation.</p> <p>Subsidize Interest Rates on Modified Loans for Delinquent Borrowers</p>	<p>Pros</p> <ul style="list-style-type: none"> • Investors receive highest NPV and servicers have flexibility to modify. • Potentially lower cost vs. guarantee against re-default

CATEGORY	STRATEGY	PROS and CONS
	<p>Investors would write down interest rates to one level, forgive interest to reduce the borrower's obligation further, and receive an compensation from the government for the forgiven amount. Writedowns should be restricted to what's necessary to meet the NPV calculation.</p> <p>Purchase Master Servicing Rights and Second Liens</p>	<p>Cons</p> <ul style="list-style-type: none"> • Could be perceived as a bail out of investors • Need to prevent investor or borrower windfall • Forgiven interest could be a tax event for the borrower.
Market Based Approach	<p>Obtain Controlling Interest to Amend Purchase enough securities on a deal-by-deal basis for a controlling interest and amend PLS contracts to eliminate restrictions on modifications.</p> <ul style="list-style-type: none"> • Leverage Fannie and Freddie holdings to quickly obtain controlling interests in issues where they have overlapping shares • Target PLS with small remaining sub classes • Prioritize purchases for products with highest defaults <p>Acquire Delinquent Mortgages as a Reverse Mortgage, in Return for Equity Stake</p>	<p>Pros</p> <ul style="list-style-type: none"> • Potential control of loan servicing • Enables modifications within legal framework <p>Cons</p> <ul style="list-style-type: none"> • May be impractical to achieve on a widespread basis. • May be difficult to obtain enough bonds to gain the necessary share. • May have to overpay for "control" bonds • Legal challenges from minority holders
Refinance	<p>Develop A Government Refi Program for Delinquent Loans Create a workable program for troubled borrowers to obtain more affordable loans.</p> <p>Offer Federal Loans for Portion of Unpaid Balance of Delinquent or New Loans</p>	<p>Pros</p> <ul style="list-style-type: none"> • PLS investor fully paid – no complication with PLS contract terms. <p>Cons</p> <ul style="list-style-type: none"> • May be seen as investor bailout, as no haircut is required • May assist borrowers who committed fraud or encourage performing borrowers to default in order to qualify
	<p>Develop a Government Refi Program for Performing Loans Refinance borrowers who are current on loans where resulting loan to value (LTV) would be >100 percent.</p>	<p>Pros</p> <ul style="list-style-type: none"> • Provides program similar to those already available to GSE borrowers <p>Cons</p> <ul style="list-style-type: none"> • Explicitly moves risk of loans to government balance sheet. • Current investors receive full unpaid principal balance (UPB), could be perceived as a bail out.

SPECIFIC RECOMMENDATIONS FOR ACTION

We believe that a combination of related and complementary approaches is needed to have a large-scale impact. These approaches combine acquiring mortgage loans in order to restructure them; voluntary efforts carried out in a streamlined, standardized manner; using insurance in a number of different ways to incent private participation and mitigate risk tails; and judicial modification for borrowers who cannot be rescued through the other methods and are forced into bankruptcy as a result.

This section first makes recommendations for distressed assets and then makes recommendations for dealing with performing but threatened assets.

These recommendations focus primarily on mortgages that are held in PLS. These represent the majority of the loans that are in delinquency, default and foreclosure. In addition, loans held in bank or GSE portfolios, or in GSE securities, are currently subject to much more flexible treatments by the portfolio owners. Indeed, the most innovative and extensive modification and forbearance plans to date have been advanced and executed by these holders. Because these holders already have extensive scope of action, they are not addressed specifically in these recommendations, except with respect to the tax treatment of modifications or forgiveness of debt or principal, which should apply equally to any borrower or lender regardless of whether the asset is in a security or is a whole loan held in portfolio.

A. Nonperforming Assets

Recommendation 7.1: Government Purchase of Mortgage Loans

The scale of the problem and the deteriorating outlook for mortgages held in PLS argues strongly for the outright purchase of outstanding nonperforming mortgages backing the bonds. TARP originally was promoted as a means to this end in order to permit the modification and restructuring of the loans. Acquisition would eliminate the complications of the bond structures. Government would become the new asset-owner and have the same scope of action available to lenders holding mortgages in their own portfolios.

Any plan to acquire these mortgage loans must consider the different broad groups of loans that are held in these trusts. These include the following:

- Performing loans
- Loans that are currently performing but that are likely to become delinquent as resets come due.
- Currently delinquent loans (30-90 days delinquent)
- Loans in default (>90 days delinquent)

The biggest obstacle to this alternative is arriving at a fair value for the loans, especially considering these critical differences, and inducing current owners to sell at that price. Current market conditions make it difficult, if not impossible, to calculate a “fair market value” for the loans. It is possible; however, to use a NPV calculation similar to the FDIC’s to generate a fair estimate of the loans’ values based on current performance, market prices for homes, and costs of foreclosure. A sample term sheet for such a calculation is included as Addendum 1.1, comparing such an approach to the current FHA Hope for Homeowners program. We recommend that government offer a discounted purchase price for these loans and require sales to be on an all-or-nothing basis, to gain control of as many loans as possible and to eliminate the potential for adverse selection by current investors in offering only some of their current portfolio.

Gaining control of these delinquent mortgage loans would give the government complete control over their disposition and yield large benefits for consumers and communities while exposing the government to potentially modest costs. It would eliminate one nagging problem presented by many of these loans that have second mortgages. Current modifications can be stymied by first lien holders demanding that second lien holders give up some or all claim to the property. Without the second lien holders’ consent, modifications can be frustrated. With the government as the sole first lien holder this question no longer applies and aggressive actions can be taken directly by the government.

There are roughly \$573 billion in loans held in PLS that are 30 days or more delinquent or in foreclosure as of September, 2008.¹⁴ If we focus only on owner-occupied, non-vacant properties and assume these equal roughly \$400 billion in total volume (an estimate only, for illustrative purposes), and assume the government purchased the loans at seventy five cents on the dollar, the entire amount could be acquired for \$300 billion ($\$400 \times .75 = \300). Further assume that 60 percent of the loans ultimately default, a very high number, with a severity of 25 percent of the discounted value, which would be comparable to market estimates of roughly 40 percent on these loans without the initial discount.¹⁵ This would leave the government with a net loss cost of \$45 billion ($.6 \times .25 = .15$, $.15 \times 300 = 45$) to clear all of these currently delinquent loans out of securities structures.

¹⁴ Figures from the fourth quarter of 2008 are almost certainly going to show even higher shares of these loans in delinquency, default or foreclosure. All current forecasts show more, not less, failures and loss severities because of the deteriorating economy and the continuing flood of failing mortgages and properties coming into an already declining market.

¹⁵ Goldman Sachs, op. cit.

With control over the loans, the government could modify loans that meet its criteria with unfettered flexibility. Payments could be written down to whatever the borrower can manage, with the government acting as a patient investor. As borrowers' circumstances improve over time, their payment plans can be further modified to the point of full amortization of the remaining amount. With these dramatic approaches, it is likely that default and foreclosure rates could be reduced significantly below the estimates used above, further reducing the ultimate cost to the government.

While requiring a large outlay upfront, this approach could resolve many otherwise intractable problems at a relatively low ultimate cost to the government. The loans could be acquired directly the Treasury, through the Fed, or using the GSEs to act on their behalf.

However, should the government not choose to buy nonperforming loans, it should aggressively set a program of loan-modification based upon the principles outlined below and tie its offer with a refinancing of performing loans also offered below.

Recommendation 7.2: Use Government Powers to Rebalance Conflicting Interests

The failure of the trustees/servicers of the private securitization trusts to adopt loan modification policies that would seem to maximize the net present value of the troubled mortgages (i.e., those in default or imminent danger of default), or the possible unwillingness of investors to sell loans to the government as outlined above suggests that stronger measures also should be considered.

One such approach that would be controversial but potentially effective would be to use the federal government's power of condemnation under 40 U.S.C. 3113 and 3114 and funding from TARP to gain control of the loans and hence of the servicing of those loans.¹⁶

This approach has three major advantages. First, the government would not have to pay a premium to entice the private sector to go along; it would simply have to pay "just compensation." Second, the government would be able to modify the loans immediately, even if determination of the price to be paid ends up in litigation. Third, if the property has additional liens, e.g., a home equity loan, the government can condemn them as well, eliminating the need to involve additional parties in the negotiation of the loan modification.

The lack of a fully functioning market for these securities and mortgages may mean that the courts will have to rely on alternative ways to establish value such as the framework laid out by the FDIC. Using their approach, the value would be the higher of: 1) the current market value of the collateral, i.e., the house, minus any losses likely to be experienced through continued servicing of the loan, including costs of foreclosure, of maintenance, of any rehabbing/repairing that is appropriate, and of any other costs (including the time value of money) incurred until the house is likely to be sold, or 2) the net present value of the income stream after the mortgage has been modified to a level that could be affordable to the borrower on a long term basis.¹⁷

While the government could take all troubled mortgages, it might be able to accomplish its goal through a more limited program which would condemn only enough mortgages to accelerate the market process for valuing troubled loans (and the securities they are in) and would also encourage trustees to modify the loans themselves in lieu of risking even lower proceeds in a condemnation procedure. The federal courts regularly deal with condemnation actions and would presumably be able to adapt their existing procedures to determine "just compensation" for these

¹⁶ While it appears that the Treasury has the authority to invoke these powers based on language in the Economic Emergency Stabilization Act of 2008 and that the courts would be willing, as they have been in the past, to take a broad view of the term "land," it may be useful to eliminate any legal uncertainty and potential litigation on these points by having Congress pass special authorizing legislation.

¹⁷ The legal standards for determining "just compensation" when the government exercises its power of eminent domain are fairly clear. The measure of how much the owner must be paid – i.e., the measure of "just compensation" — is "the market value of the property at the time of the taking." *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1969) (quoting *Olson v. United States*, 292 U.S. 246, 255 (1934)); see *United States v. Clarke*, 445 U.S. 253, 258 (1980). "Under this standard, the owner is entitled to receive 'what a willing buyer would pay in cash to a willing seller' at the time of the taking." *United States v. 564.54 Acres of Land*, 441 U.S. 506, 511 (1979) (quoting *United States v. Miller*, 317 U.S. 369, 374 (1943)). "The Fifth Amendment does not require any award for consequential damages." *50 Acres of Land*, 469 U.S. at 33. It is worth noting, however, that, in determining the fair market value of property that is taken, the increased value that is attributable to the government's own actions is not taken into account. See, e.g., *Miller*, 317 U.S. at 377 ("The owners ought not to gain by speculating on probable increase in value due to the Government's activities."). The authors are grateful to Jim Feldman for his contributions and insights in this section.

cases. Hopefully, the prices being set through this process would hasten the time for the development of a market for these troubled mortgages and for the securities they are in.

Use of eminent domain is a controversial alternative. Under current legal standards, the government fairly clearly has the power to take mortgages or interests in mortgage under its power of eminent domain, given appropriate legislation to ensure that Congress has authorized it. The primary constitutional restriction is that the land has to be taken “for public use.” In *Kelo v. City of New London*, 545 U.S. 469 (2005), the Supreme Court held that the “public use” or “public purpose” requirement was satisfied when a real property interest was taken for purposes of economic development of a community, even though the effect was to transfer the land to a private developer. In *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984), the Court held that the same requirement was satisfied when a state took title from some lessors and gave it to lessees, because the concentration of land ownership in the state’s view “created artificial deterrents to the normal functioning of the State’s residential land market.” 467 U.S. at 242.

The current system of securitized mortgages often leads to the result that *no one* has authority to make mortgage modifications that would be beneficial to borrowers, most lenders, neighbors, and the community as a whole. Under *Kelo*, and even more clearly under *Midkiff*, the public purpose of returning to normal and effective functioning of the mortgage market is sufficient to find that condemnation of mortgages (or interests in mortgages or mortgage pools) would be for a “public purpose,” even if those interests, once condemned and modified, were simply sold to other private parties and not held by the government. While it is not impossible that there would be a legal challenge on this basis, the Supreme Court is unlikely to overturn or substantially limit a precedent as recent as *Kelo* at this time. The five-Justice majority in *Kelo* (Stevens, Kennedy, Souter, Ginsburg, Breyer) remains on the Court today. The legal risk that a condemnation would be held to be unconstitutional is minimal.

Condemnation of mortgages or interests in mortgages or mortgage pools has one clear advantage over any other means of removing the obstacles that prevent reasonable modifications of mortgages: it could operate quickly, since the government could condemn and take control of the mortgages or mortgage interests before the conclusion of judicial proceedings to determine how much the government must pay. But it also has significant disadvantages: the cost to the government could be uncertain, the litigation process necessary to determine the cost to the government could take years and be very complex, and the ultimate cost could potentially be very high. Valuation in general is a notoriously tricky matter, and there are ordinarily multiple ways at arriving at the value of a piece of property, especially an abstract property interest such as a mortgage or an interest in a mortgage. Especially given current market conditions, it is difficult to predict just how a court would value mortgages or interests in mortgages, and a court in a condemnation case may be tempted to give the benefit of the doubt on at least some occasions to the owner whose property has been taken.

Recommendation 7.3: Legal Changes to Facilitate Resolution

Another obstacle to sales is that, because trusts are intended to be purely passive entities, there are restrictions against them selling assets at a discount. Congress should pass legislation permitting government purchase of loans under REMIC tax rules and providing that continued REMIC status is contingent on pooling and servicing agreements (PSAs) being modified to permit (but not require) participation in this process as well as in modifications.¹⁸ Finally, Congress, the SEC or Financial Accounting Standards Board would need to ensure that accounting standards change to permit these sales. The current application of FAS 140 appears to be a significant obstacle to the sale of mortgage assets out of these trusts, but one that could be remedied fairly easily through the Finance Accounting Standards Board and SEC.

Congressional adoption of the REMIC pass-through changes recommended above also would provide an important incentive for investors, servicers and trustees to cooperate in any government-sponsored purchase plan.

¹⁸ See Center for American Progress, Issue Brief: Overcoming Legal Barriers to the Bulk Sale of At-Risk Mortgages, April 2008, available at http://www.americanprogress.org/issues/2008/04/reimc_brief.html.

B. Modifying Distressed Mortgage Assets

In lieu of the government acquisition plan outlined in Recommendation 7.1, or as a complementary approach for those investors who cannot be persuaded to participate in such an acquisition initiative, we believe there are other important steps to consider to facilitate the preservation of homes secured by troubled or nonperforming mortgages.

Recommendation 8.1: HUD should urge Treasury to implement the streamlined loan modification plan proposed by the FDIC and authorized by TARP whereby the government would pay an administrative fee to servicers and guarantee sustainable loan modifications made following the plan's protocols at a 50% level.¹⁹

FDIC estimates that their plan could reduce foreclosures by one-third. This plan could be quickly implemented by Treasury and could lead servicers to implement a systematic and streamlined process to substantially reduce foreclosures. It addresses a number of concerns that have limited loan modifications to date: its net present value analysis, using more standardized assumptions that are transparent and clearly explained, would demonstrate to investors why a successful modification is a better outcome than foreclosure; the administrative payments to servicers offset countervailing incentives to foreclose that are built into the structure of the servicing industry; the modifications can be made with second liens remaining in place because of its consideration of first mortgage affordability; the initial six-month performance requirement will weed out participants with no chance of succeeding and ensure that modifications will provide a reasonable level of affordability; the focus on first-mortgage debt-to-income makes it easy for servicers to administer; and the requirement that servicers apply the protocols to all loans in a servicer's portfolio removes any chance of their adverse selection of loans.

The FDIC's prescribed loan modification measures involve a three-step, transparent process to try to bring the borrower's payment down to an affordable level:

1. First, the interest rate is reduced. The rate may be no higher than the Freddie Mac weekly survey rate at the time of the modification, but can be reduced down to 3 percent. Beginning five years after the loan modification date, the interest rate is gradually increased over time until it again reaches the Freddie Mac weekly survey rate that was in effect at the time of the modification.
2. If this approach is insufficient, the term of the modified loan may also be extended, from 30 up to a maximum of 40 years.
3. Finally, if reducing the interest rate and extending the term is still not enough, the lender may employ "Partial Principal Forbearance." With Partial Principal Forbearance, the lender splits the debt into an interest-bearing, amortizing portion (at 3 percent, 40 years) and a zero-percent, zero-payment portion of the loan. FDIC continues: "The repayment of the 'postponed' principal will be due when the loan is paid in full. For loans within securitizations, this principal forbearance should be passed as a write-off of principal to the trust, with any future collections at time of pay-off submitted to the trust as a recovery."

It is true that some modifications under the FDIC protocol may be less sustainable than a more careful, case-by-case analysis. The FDIC approach does not consider the full debt picture and residual income of the homeowner, does not make permanent principal reductions, and does not require cancellation of second mortgages. However, there would be nothing to stop participating servicers from taking these additional steps. In the end, we believe the urgent need to do streamlined modifications on a mass scale outweighs those concerns.

One estimate is that roughly 3.2 million loans would qualify for this mass modification approach over the next 2 years, at an estimated cost of \$40 billion in insurance pay-outs to servicers, and that around 2 million of these modifications would be successful in enabling borrowers to keep their homes by keeping their loans current.

Banks, Fannie Mae and Freddie Mac, along with the FDIC, are already carrying out streamlined modifications like this model, without the insurance guarantee of revenue streams. Servicer response to Fannie Mae's model is reported to be very high.

Recommendation 8.2: Remove Securitization Obstacles by Modifying REMIC laws

Roughly half of subprime PSAs have restrictions that limit servicers' and trustees' discretion to modify mortgages even when such modifications are in the best interests of investors.²⁰ As a result, many investors are being ill served by their

¹⁹ Details of the plan can be found at <http://www.fdic.gov/consumers/loans/loanmod/index.html>

²⁰ See Kevin Byers, CPA, "Summary of Analysis: Loss Mitigation Provisions in Selected Subprime Securitizations," 12/20/08

servicers, because the net present value of a modification often is greater than the costs if the loan is foreclosed, even factoring in the possibility that the modified loan will redefault in a declining market. Such restrictions include limits on the type of modification that can be done (such as prohibiting principal reduction, interest rate reduction or term extensions) or requiring approval by a third party (National Incident Management System [NIMS] insurer, ratings agency, master servicer or subordinate tranche holder) before doing any modification at all or exceeding a 5% cap on a pool's number of loan modifications. An additional type of restriction is the imposition on servicers of an obligation, either expressly or through implication, to maximize a mortgage pool's assets for the benefits of each class of investors, rather than for investors as a group. This type of restriction – or even uncertainty concerning the servicer's obligations in this area – can also be addressed by making REMIC treatment contingent on clarifying that the servicer's obligation to maximize value in modifying mortgages extends to all investors as a group, not to any particular class of investor.

Congress should make its favorable REMIC pass-through tax status contingent on changing the PSAs to remove artificial obstacles to modifications where servicers and trustees do not need investor approval to do so.

In addition, REMIC status should require public reporting of modification activities, including protocols, inputs to its NPV analysis, and outcomes. The modification protocols are important to understand. NPV inputs are simply a black box for servicers and can easily be manipulated to justify foreclosing with assumptions of unrealistically high discount rates, redefault assumptions, or property decline rates. And reporting on outcomes has failed to tie performance to the specific type of modification chosen, which reduces the ability to learn what works best.

Recommendation 8.3: Examine the Value of Incorporating a Form of Shared Appreciation Into Modifications

Partnership Mortgages (PM), a form of shared appreciation mortgages, are an attractive loan modification approach that allow homeowners to stay in their homes while providing a mechanism for lenders to recover some or all of their investments. PMs incorporate two essential elements:

1. A current-pay obligation that can be prudently underwritten, given current loan-to-value and homeowner affordability constraints. The homeowner makes regular monthly payments on this portion of the existing mortgage.
2. A deferred obligation representing the remaining balance of the existing mortgage which requires no current payments of principal or interest. This portion is due to the lender upon resale of the property, along with a share of appreciation in the home over the value at the time of modification.

Note that the FDIC's Partial Principal Forbearance mechanism is effectively a Partnership Mortgage with a zero percent appreciation share. Taking some share of potential appreciation along with the return of the 'postponed' principal will increase NPV and therefore increase the number of loans for which modification is preferred to foreclosure from the investor perspective. The consumer will pay more at that point than if they did not have to share appreciation, but the solution is far preferable for them than going to foreclosure.

Moreover, there is ample reason to include a shared appreciation approach within the FDIC-prescribed measures even in those instances where Partial Principal Forbearance is not employed. Specifically, the reduction in interest rate (the first step in the FDIC process) also reduces the investor return. There is no reason that the investor could not have the opportunity to recover some of this discount by charging a share of the appreciation upon resale. There is actually a federal government program that provides a precedent for exactly this idea, namely the U.S. Department of Agriculture (USDA) Rural Development Section 502 loan program. This loan program helps homebuyers purchase a home at a steeply reduced interest rate (sometimes as low as 1 percent) – but keeps track of the amount of interest the homebuyer has saved compared to a market rate loan. This amount of discounted interest can then be recovered by the USDA by taking a share of appreciation (USDA typically takes 75 percent of appreciation, up until the discounted interest is fully recovered).

A model for integrating the Partnership Mortgage approach within the FDIC loan modification system might therefore work as follows:

- The investor takes a share of appreciation in the home – for example, 50 percent of future appreciation above the current market value at the time of the modification – to recover interest rate discounts provided as a part of the modification.

- This shared appreciation is capped at no more than the value of the interest rate discounts provided.
- If Partial Principal Forbearance has also been employed, the investor may continue to take a 50% share of appreciation above this cap to earn a return on the Partial Principal Forbearance. If desired, a second cap could be applied on this additional shared appreciation (e.g. at no more than a certain return on the amount of the Principal Forbearance).
- Any appreciation that must be used in order to satisfy the borrower's obligation to repay the principal amount of the Partial Principal Forbearance is taken out of the basis used for the above shared appreciation calculations. In this way, the homebuyer is assured that they will not owe any shared appreciation payments if they must use all of the appreciation in the property to pay off the principal amount of the Partial Principal Forbearance.
- Shared appreciation payments would be due upon the refinance or actual sale of the property (as is the case with the return of principal of the Partial Principal Forbearance).

One could readily integrate a house price appreciation forecast and length-of-tenure assumption into the FDIC NPV model to determine the expected value of shared appreciation payments. Note that the expected value of adding a share of appreciation to the modified loan is always positive. (If property values are flat or declining, the shared appreciation is worth zero; if they increase the shared appreciation is worth a positive number; therefore the expected value is never negative and likely will be positive at least some of the time.) Thus, by definition, this approach will boost the expected investor NPV of the modification approach by some factor and therefore likely increase the number of loans that go to modification under FDIC's decision rule.

Importantly, this shared appreciation mechanism would also act as a way to reduce the moral hazard fear that borrowers will intentionally default on their loans if they believe it will lead the lender to offer them a favorable modification.

Recommendation 9: Ameliorate tax consequences of foreclosure crisis.

Loan modifications containing a principal write-down or, in certain circumstances, a significant interest rate reduction, potentially cause tax liability for borrowers. Such taxes owed could threaten loan modifications with the best chance of succeeding. The Mortgage Forgiveness Debt Relief Act of 2007 is narrowly written and therefore will not help most homeowners who have refinanced their mortgages and/or consolidated any other debts into their mortgages. A legislative solution should ensure that homeowners are protected more broadly against extra taxes, which will prevent later problems when struggling families are surprised by a tax bill they cannot pay.

Recommendation 10: Permit judicial modification of mortgages in Chapter 13 bankruptcy.

Another effective way to break through the barriers put up by servicers and investors to effective and fair modifications is to empower a court to implement an economically rational solution where the parties cannot do so on their own. This would solve the servicers' fear of investor lawsuits (no liability can arise from compliance with a court order), would solve servicers' financial incentives and lack of qualified staff, and would solve the problem of junior lien holders, whose cooperation can be compelled by the court. This is what bankruptcy courts do every day, for all manner of debts, except for the mortgage on the primary residence.

Bankruptcy is not a solution of first resort. But if all other efforts by borrowers, government agencies, and others fail, then consumers should have the right to the full protection of a bankruptcy court as an ultimate recourse. Simply knowing that a loan could be restructured by a bankruptcy court if the borrower and servicer/investor cannot find an equitable accommodation earlier likely will change the servicers' and investors' cost-benefit analysis in ways that could favor more aggressive efforts to modify loans.

Currently, a loan on a family's primary residence is the only secured debt that cannot be restructured in a chapter 13 payment plan bankruptcy.²¹ The home mortgage exception dates to the enactment of the current Bankruptcy Code in 1978, and was included in the Code to advantage mortgage lending. Mortgage lending then was a conservative business, and home mortgages were nearly all fixed-interest rate instruments with low loan-to-value ratios. If a family ran into financial trouble, the home mortgage itself was rarely the source of the distress. Moreover, lenders held mortgages on their own books and so had the incentive and ability to modify loans when appropriate.

²¹ The relevant provision is found at 11 USC §1322(b)(2), which empowers the court to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of unsecured claims."

Whatever the merits of the exclusion in 1978, the mortgage market has shifted considerably since then. First and foremost, lenders typically no longer hold the loans and so no longer have the ability to modify where appropriate. Further, in the last six years, loan originators aggressively marketed complicated loans that started with affordable payments that were set to increase substantially. These subprime and Alt A loans could not be sustained absent repeated refinancing, which depended upon a rising housing market. In these circumstances, the home mortgage exception does not make sense. Moreover, in the current economic downturn, homeowners across the economic spectrum are more vulnerable to foreclosure because fallen property values and stressed credit markets limit the ability to sell or refinance. If borrowers cannot restructure these debts, they will be forced into foreclosure. Today, the home mortgage exception is contributing to the downward economic spiral. The recent announcement of a compromise proposal endorsed by Sen. Richard Durbin (D-IL), the measure's Senate sponsor, and Citigroup, limiting the bill to existing loans and requiring borrower contact to receive a modification before filing, is a positive development that should accelerate adoption of this change.²²

There is clear precedent for eliminating the home mortgage exception. Congress implemented a similar measure in response to the farm crisis of the 1980s when an economic downturn and depressed land values were pushing family farmers into foreclosure. Congress enacted the Family Farmer Bankruptcy Act of 1986, for the specific and express purpose of permitting bankruptcy judges to modify mortgages on family farms, permitting adjustment of interest rates and the reduction of principal to fair market value, in order to help distressed farmers avoid foreclosure, including on their primary residence. Chapter 12 proved effective in helping farmers through the crisis, and did not give rise to any of the problems, discussed below, that are now raised as concerns about the current bill. In fact, after being extended several times, the Act was made a permanent part of the Bankruptcy Code, with bipartisan support, in 2005.

C. Addressing Performing Mortgage Assets

Market conditions have brought mortgage interest rates to historically low levels. Yet millions of current homeowners have been unable to take advantage of these lower rates. Some borrowers have positive equity in their homes, but plunging home values have reduced these to an extent that a refinancing would require a loan-to-value ratio above 90 percent. Such loans typically require mortgage insurance or some other form of credit enhancement in order to be eligible for sale to Fannie Mae or Freddie Mac. But private mortgage insurance is either unavailable or too costly because of the mortgage crisis' impact on mortgage insurers. Other borrowers had positive equity in their homes before the downturn, but falling home prices now mean that they are effectively underwater, with their outstanding loan balance higher than the home's current appraised value.

Lenders who own whole loans in this situation have a strong incentive to facilitate refinancings through streamlined modifications because they already hold the credit risk on the loans. Reducing monthly payments on the current outstanding balance only improves the likelihood that the loan will repay. Fannie Mae and Freddie Mac have similarly aligned interests with the homeowner when they own the loans. But these interests are not clearly aligned on mortgage debt held in private label securities on homes that are "underwater" where borrowers are current in their payments and making every effort to continue to do so. These borrowers are locked out of the refinance market because servicers and investors will not modify current interest rates on performing loans, and new lenders are unable to offer financing for underwater properties. Billions of dollars of potential consumer demand is locked up in older home loans that could be released through a refinancing of performing loans.

Recommendation 11: Create an FHA-insured streamlined program that would insure refinancings of performing loans up to 120 percent LTV.

There is an estimated \$1 trillion in outstanding, current Alt-A and subprime debt held in private label securities, and about 42 percent of these are underwater.²³ Mortgage rates are at historic lows, and many of these borrowers are currently carrying mortgages that are 200 basis points or more above these rates. In addition, some of them are facing adjustable mortgage rate resets or other features that could reduce their ability to repay. These performing mortgagors

²² "Citi Reaches Deal with Lawmakers on Home Loans," *Washington Post*, January 9, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/01/08/AR2009010802368.html>

²³ The largest portion of these underwater loans are in a handful of seven states that have experienced the most dramatic house price declines – CA, NV, FL, AZ, MI and OH. Estimates of underwater loans are taken from *Inside B & C Lending*.

in many cases are victims of steep house-price declines caused by irresponsible credit decisions by others and are unable to refinance their current loans to take advantage of these lower rates and better terms as a result. Leveraging FHA insurance to help these borrowers refinance into lower cost, stable loans would achieve several important objectives:

1. It would have an immediate stimulative effect by reducing mortgage payments, in some cases by significant amounts. If a borrower is able to refinance out of a 7 percent \$200,000 loan into a 5 percent loan, both amortizing over 30 years, the monthly savings would be roughly \$250 per month, or \$3,000 per year in additional cash.
2. By encouraging continued repayment of outstanding mortgages, it would reduce the potential stream of foreclosures and the attendant reductions in surrounding property values.
3. Enabling refinancings would immediately reset the value of mortgage bonds in which these loans are held by providing a greater assurance of principal repayment above currently deeply discounted mark-to-market values. This would reliquefy the mortgage-backed securities (MBS) market, provide capital relief to institutions holding the instruments by enabling them to assign them a higher value, and deleverage the chain of transactions like credit default swaps and CDOs that are priced against these securities.

FHA would provide mortgage insurance to enable performing borrowers whose loans are underwater to refinance their current loans into new 30-year fixed rate loans. Loans would be limited to the applicable FHA maximum loan amount with no cash-out refinances allowed. Premiums for this insurance would be paid by the borrower. TARP funds could be used to provide contingent funding in the event that charged premiums for this coverage did not cover losses. Insurance would be capped at a maximum level of 120 percent LTV, and should only cover losses down to 80 percent of principal balance (so the loans could be bought by the GSEs). This coverage would provide an effective 40 percent guarantee of principal against a possible borrower default. This is 20 percent less of a guarantee than is proposed under the FDIC modification plan, which would offer a 50 percent government guarantee against a redefault.

Eligible borrowers would be restricted to owner-occupants current for at least the last 12 payments on their current loan. This is a high credit quality standard. It could be set to something lower to engage more borrowers, but the overall credit quality of the guaranteed book would be lower as a result. It also is possible that additional factors, such as liquid cash reserves on hand, overall debt to income ratios and other common underwriting standards could be used to further screen and qualify potential participants. However, the more terms are required, the more complex the underwriting of the new loan will become, slowing down turnover.

In return for the new credit insurance, borrowers would have to pay a fee and agree to have new payments automatically drafted from their checking accounts, to strengthen repayment performance.²⁴

This refinancing scheme could achieve several policy objectives. First, it could assist any current owner to take advantage of historically low interest rates and provide a stimulative effect in the economy by releasing cash from current mortgage payments. Second, it could give consumers a market-based escape from current Alt-A or subprime mortgages that servicers are unwilling to modify unless borrowers have missed payments. There are anecdotal reports of many homeowners struggling to make mortgage payments on time who are told by servicers that no modifications are possible on their loans unless they have become delinquent. This is a perverse incentive for borrowers to miss payments simply to achieve a more reasonable payment amount. FHA insurance could give these borrowers a clean exit strategy and convert Alt-A and subprime loans to 30 year fixed rate loans. Third, it provides performing borrowers with relief at a time when nonperforming borrowers are the focus of most policy initiatives. It rewards the good behavior of current, performing borrowers and incents their continued performance in an uncertain market environment. The initiative would help alleviate the moral hazard concern that assisting nonperforming borrowers will incent more borrowers to miss payments in order to benefit from some relief from their current obligations. Fourth, providing a means for these loans to refinance would enhance the value of the bonds now backed by them by providing a higher degree of certainty for a principal repayment on a portion of the outstanding book. This could have a positive capital impact on the institutions holding the bonds, inject new liquidity into the markets through

²⁴ Such automatic payment plans have proven to have a very high performance factor, with significantly lower delinquencies and defaults than on loans that are similar in all other respects. Such a requirement would ensure that mortgage debt is the highest priority in a consumer's spending and would effectively put such payments in the premier position for payment. Such a restriction is an appropriate trade off for the benefit of the new loan insurance.

more active trades, and deleverage the chain of other investments like credit default swaps and CDOs that are based on these securities.

It also could create new incentives for investors to undertake modifications of nonperforming loans remaining in the pools. These government-supported refinancings will generate pay-offs to investors in line with the subordination structures of the PLS. While the share of distributions will vary between different specific securities, the subordinated investors will get smaller amounts. As these “in the money” assets run off, the subordinated bondholders’ likelihood of receiving further returns diminishes, and the refinancings increasingly leave a much weaker remaining book of business. This decreasing prospect of any further return from the remaining loans could have the effect of realigning the interests of all the bondholders in favor of modifications or discounted sale to the government, as proposed earlier in this paper, in order to secure the highest possible return in the shortest possible time. In other words, by stripping out the performing assets, the refinancing initiative also could make the nonperforming loans easier to acquire and/or modify.

These refinancings could be accomplished using streamlined procedures to minimize costs and maximize participation by eligible borrowers. Servicers holding the current notes would use modified and streamlined approaches to modify the notes to reflect the new interest rate and then bundle the notes to swap into a new Fannie Mae or Freddie Mac security. The FHA insurance could be applied by the servicer if it has delegated underwriting authority, or FHA could authorize Fannie and Freddie to do so. The new securities could be sold to the Fed, or to Treasury at the new rates, and the cash then passed back through the trust to liquidate the original loan to the investors. The Fed or Treasury as the ultimate investors would receive the new interest payments. FHA would bear the risk of up to a maximum of 40 percent of the loss on a foreclosure, with the Fed or Treasury bearing the balance beyond ultimate sales recovery. Fannie and Freddie could also guarantee the remaining portions of the notes and charge a guarantee fee to do so, or the government could agree to purchase these notes without the traditional GSE guarantee. This would lower costs further to consumers, since the note rates would not include a guarantee fee, but would increase the ultimate risks to the government. Given the current capital constraints facing the GSEs, and the nature of the Treasury’s backstop arrangement with them, it isn’t immediately clear which path is likely to provide both the fastest execution and the best long-term value to the government.

Key concerns for FHA would include the following:

1. Adverse selection risk
2. Insuring in weak markets and risking steeper losses through further price declines
3. Potential high severity risk from defaults

Costs

There are an estimated \$1 trillion worth of currently performing Alt-A and subprime mortgages held in private label securities (*as of the end of 3Q2008*). Given the proposed limits on the program, significantly less than this amount would refinance using the insurance. Assuming a take up of half the total amount in this group for purposes of illustration, or \$500 billion, and a default incidence rate of 15 percent, higher than in normal times but significantly below current overall high levels in subprime and Alt-A loans, and a severity rate roughly calculated at a maximum of a 40 percent exposure, potential losses over 5 years in this program could range up to \$30 billion for FHA. This level of severity is consistent with market estimates of expected losses from these loans; if they are higher, the Fed or Treasury would be exposed to possible further loss. If they are smaller, or if home prices rise sufficiently while the loans are outstanding, there could be much smaller losses to both FHA and the ultimate investor. It is also unlikely that all borrowers will have severities at these highest rates, or that the amount of insurance coverage would be at the maximum level for all loans. But this calculation assumes the worst for all borrowers, thereby yielding an estimate that is more likely to reflect the worst case outcome. If a 1 point fee were charged to the borrower on the assumed outstanding balance of \$500 billion, \$5 billion would be raised to insure against losses. TARP funds or some other source of backstop would have to be available to augment insurance premiums for such coverage.

Recommendation 12: Use the GSEs.

Fannie Mae and Freddie Mac provide ready-made tools with high degrees of sophistication and expertise in the mortgage modification and asset acquisition/management business. Both companies have extended new tools to assist borrowers whose loans they own or guarantee, including Home Saver Advances[©] that provide borrowers who have missed payments a personal loan that allows them to become current; a standardized modification program for

loans that have been taken out of mortgage security pools; a foreclosure moratorium²⁵; and allowing renters to remain in foreclosed properties. Fannie Mae recently announced an extensive effort to enable renters to stay in homes and to offer them the opportunity to buy the homes. Freddie Mac has indicated it has similar plans.

Under Conservatorship and the terms of the Treasury investment in September, 2008, both firms are laboring under certain restrictions that make their greater involvement problematic. These include limitations on their overall debt; expectations that they will begin shrinking their portfolios by 10 percent per year beginning in 2010; and large amounts of long-term maturing debt that may prove difficult to roll over because of regulatory and market conditions. However, if these problems could be remedied and the GSEs given a clear mission by the Conservator to engage aggressively in modifying mortgage assets, exploring innovative ways to standardize servicing through acquisition of a platform, and other means, we believe that they could be a powerful tool in this effort.

The GSEs could be used as the principal means to acquire mortgage assets in Recommendation 7.1.

The GSEs also could be the source of liquidity for the refinancing of performing assets. While these would now carry an FHA credit enhancement, they could be held in either of the GSE portfolios, or the GSEs could be used as the purchase conduit to create securities for the Fed or Treasury to buy and hold.

FHA could authorize the GSEs to place FHA insurance on loans they acquire through the proposed performing borrower refinance program when originating lenders are not delegated underwriters. FHA also could do this to encourage new borrowers who need loans with above 90 percent LTV who cannot obtain private mortgage insurance, by allowing FHA insurance to be placed by the GSEs on such loans that receive “approve” recommendations from the GSEs’ automated underwriting engines.

The GSEs also could be used to create or acquire and support a special servicing platform that would provide “best in class” models of servicing distressed assets and increasing the success of modification efforts. Because of their large participation in the market and ability to use such a platform across a potentially large universe of loans, especially if they are used to acquire mortgage assets, they could have a significant impact. There likely would be industry resistance to this effort because of concerns about expansions in the GSEs’ approved activities, and fear of their potential competitive advantages. However, given servicers’ myriad failures to effectively address the current crisis, establishing such a capacity within the GSEs is a reasonable step.

²⁵ Both Fannie Mae and Freddie Mac have extended this moratorium until January 31, 2009

ADDENDUM 1.1

A. Foreclosure Mitigation Using Net Realizable Value and Second Lien Mortgages

- A mitigation approach that provides beneficial incentives for both financial institutions and homeowners
 - Preserves homeownership by allowing owners to refinance to an affordable new mortgage.
 - Financial institutions retain an equity share in the property with the possibility of sharing in future home appreciation rather than writing-off losses today.
- New Refinanced First Mortgages will be offered to households in foreclosure and will be sized based on the lesser of:
 - the Market Value, as determined by an appraisal, broker’s price opinion or automated valuation model,
 - the Net Realizable Value, as calculated based on the savings to a lending institutions associated with refinancing the property today rather than assume the uncertainty of carrying a property for some indeterminate time in a declining market and selling on the open market through a broker, or
 - the maximum affordable mortgage based on the gross income and household size of the homeowner.
- Financial institutions will establish second lien mortgages on the properties, sized based on difference between first mortgage and outstanding debt.
- A wide variety of mortgage sources:
 - New first mortgage could be funded through tax-exempt bonds, Federal Housing Administration (FHA), Fannie, Freddie, etc.
 - Second lien mortgages could be purchased by Troubled Assets Relief Program (TARP) or a secondary market could be created.

B. Foreclosure Mitigation Term Sheet

Term	FHA Hope Provisions	Proposed Program
Qualifying Property	No limit on the home price. But, the maximum amount of the new mortgage must not exceed 132% of the 2007 FHA limit. FHA 2007 Loan Limit = \$417,000. Max new Loan limit would be equal to 417,000 x 132% = \$550,440.	[Same] [Property in good repair] [Single family, condominium] [No manufactured housing]
Qualifying Income	No Limit.	[Same]
Qualifying Loan	No qualifying loan provisions – presumably any type of loan could be refinanced. The program does not begin until 10/1/2008 and ends 9/30/2011.	[No qualifying loan provisions; any loan can be refinanced; program start and end date TBD]
Owner Occupied	Must be principal residence of the borrower.	[Same]
Qualifying Borrower	Borrower must “lack capacity to pay existing mortgage.” <ul style="list-style-type: none"> • Borrower must certify that i) has not intentionally defaulted on mortgage or ANY other debt and ii) hasn’t furnished materially false information to obtain a mortgage; • As of 3/1/2008 borrower must have a ratio of total mortgage to debt income of at least 31%. Borrower must not have been convicted of fraud, including mortgage fraud.	[Additional requirement: Must be 90 days delinquent or foreclosure action begun] [Debt/Income ratio of 31%?]

Term	FHA Hope Provisions	Proposed Program
Voluntary Program	All lienholders must agree to the refinancing.	[Same]
Waiver of Prepayment Penalties and Fees on Existing Mortgage	Prepayment/refinancing fees and all fees/penalties related to default/delq on the existing mortgage must be waived or forgiven.	[Same]
Determination of Principal Amount of New Mortgage	No greater than 90% of the appraised value of the property to which the existing mortgage relates. Any appreciation is shared between FHA and borrower.	[New mortgage is sized on the lesser of (a) the Net Realizable Value of the property based on the attached pricing formula or (b) the current appraised value of the property or (c) the maximum amount of debt the homeowner can afford based on the underwriting criteria of the Program]
Sharing Losses Between Existing Lienholders	The HOPE Board will establish procedures by which all lienholders will share losses. The Board is also permitted to establish policies to allow for payment to existing subordinate lienholders of a portion of the future appreciation that is owed to FHA. (See comment above related to FHA's share of appreciation.)	[Existing loan is bifurcated into New Mortgage sized as above and a new 2 nd mortgage equal to the difference between the Original Mortgage and the New Mortgage]
Terms of New Mortgage	Fixed rate with a principal amortization term not less than 30 years.	[Same]
Extinguishment of Existing Loans	ALL holders of outstanding mortgage liens shall agree to accept proceeds of new mortgage as payment in full.	[Same]
New Second Mortgage: Terms	N/A	Co-terminus with New Mortgage. Due on sale or refinance. Equity share with homeowner in proportion TBD.
Prohibition on Second Liens	No new second liens for the first 5 years of the new mortgage (See comments.)	[Same]
FHA Insurance Premium	3% upfront mortgage insurance premium (MIP) and 1.5% annual MIP	[FHA and other sources of financing for New Mortgage are allowable.]
Tax-Exempt Bond Authority	No such provision.	[Eligible]
Duration of the Program	No new commitments for refi may be entered into after 9/30/2011.	[TBD]

C. Key Assumptions Used in Valuation Worksheet

- The Valuation Worksheet provides an illustrative example of how a loan mitigation might be restructured.
- The analysis assumes an original purchase price of \$300,000 with a 100% loan-to-value loan.
- Three periods are depicted:
 - Pre-foreclosure: the period in which debt service payments are delinquent. This model assumes a 90-day delinquency period.
 - Foreclosure: the period in which a foreclosure action is taken. This model assumes that the process takes 120 days.
 - Real estate owned (REO): the period after foreclosure when the financial institution has taken title to the property. This model assumes that it takes 120 days for the financial institution to sell the property through a broker from the time that they take title.
- The analysis assumes mitigation action in the fourth month, in lieu of foreclosure proceedings.
- The analysis assumes that the market value of the property declines by 2% per month, as determined by an appraisal, a broker's price opinion or an automated valuation model.
- Holding costs during the pre-foreclosure and foreclosure periods include debt service, real estate taxes, insurance, utilities, and maintenance. Additional holding costs after foreclosure include interim repairs, which presumably have been deferred, administrative costs, third party costs and a broker's fee upon sale.
- The new First Mortgage is calculated based on the lesser of:
 - Market Value,
 - The Net Realizable Value, as calculated based on the savings to a lending institutions associated with refinancing the property today rather than assume the uncertainty of carrying a property for some indeterminate time in a declining market and selling on the open market through a broker, or
 - The maximum affordable mortgage based on the gross income and household size of the homeowner.
- The Second Lien Mortgage is calculated based on the difference between the Original Outstanding Debt and the First Mortgage.

ADDENDUM 1.2

The following paper is included particularly because of its lucid explanation of the ways in which mortgage bonds have been leveraged through the use of collateralized debt obligations (CDOs) and credit default swaps (CDS). We do not endorse the paper's recommendations, but believe their analysis is a helpful supplement to the information we have provided, and we drew on their observations in formulating our recommendations.

MEMORANDUM ON REMEDIATION OF SUBPRIME MORTGAGES

By Verum Capital, www.verumcapital.com

One of the most prevalent misconceptions about the bailout is the assumption that the government must decide whether to use its limited resources to help Main Street (the homeowners) or Wall Street (the institutions that own the mortgages). Ironically there is no tension between these two objectives: *the most efficient means of bailing out Wall Street would be for government to shore up Main Street by fixing mortgages*. Momentum has been building to refinance borrowers current on subprime mortgages into affordable fixed rate loans as a means of preventing foreclosures and stabilizing the housing market. The government should also encourage the private sector to remediate delinquent loans in subprime securitizations. By allowing borrowers current on subprime mortgages to refinance into GSE-style loans and encouraging banks to work together to purchase and modify delinquent securitized loans, the government would help homeowners, boost the real estate market, inject capital into the banking system, and cleanse the balance sheets of institutions that hold illiquid structured assets exposed to subprime risk.

Verum Capital has been working for the past year on the remediation of securitized non-performing mortgages. Our examination of the banking sector's levered exposure to certain Residential Mortgage Backed Securities (RMBS) has led us to conclude that the remediation of non-performing mortgages is a taxpayer efficient means of enabling the banking system to help homeowners by reducing foreclosures while reversing significant mark-to-market losses.

Leveraged Exposure to Subprime Mortgages

The government should encourage the banking system to purchase and modify delinquent mortgages from RMBS to which banks have a leveraged exposure. This will cause the same leverage that contributed to the current credit crisis to work in favor of the bailout initiative. Purchasing mortgages at Par from certain RMBS securitizations will return more principal to investors than the cost of any losses on such purchases. By focusing on the underlying mortgages, the bailout can repair the RMBS that hold the mortgages, the derivatives that refer to the RMBS, the collateralized debt obligations (CDOs) that are invested in RMBS, and the derivatives that refer to these CDOs.

Financial institutions acquired exposure to RMBS by investing directly, by unwinding Structured Investment Vehicles (SIVs), and by taking risk to senior tranches of CDOs that invested in RMBS which, given the erosion of the subordinate classes of a CDO, is now equivalent to owning each of the RMBS in which the CDO invested.

CDOs gave rise to the leverage that makes it cost effective to buy delinquent mortgages from certain subprime securitizations. Starting in mid-2005, collateral purchased by CDOs tended to include not only cash RMBS securities but also Credit Default Swap (CDS) contracts that referenced these securities. This is illustrated by considering the \$55 billion of mezzanine CDOs underwritten in 2006. These CDOs purchased approximately \$50 billion of mezzanine RMBS collateral, despite the fact that only \$14 billion of mezzanine RMBS securities were issued. The difference was comprised almost entirely of CDS contracts. The advent of CDS in CDOs made it possible for the market as a whole to build up an exposure to a given class of an RMBS securitization that was larger than the size of that class, in particular the classes rated A3 through Baa3. The total notional of CDS referencing a cash bond often exceeds the notional of the cash bond, in some cases by a multiple of 40 to 50 times. The total amount of CDS on RMBS written by CDOs was over \$125 billion.

Suppose that a given subprime securitization comprises a mezzanine bond with \$10 million outstanding and a senior bond with \$90 million outstanding, and suppose that speculators shorted the mezzanine bond by entering into CDS on an outstanding amount of \$50 million. Then the exposure multiple¹ for the securitization is 1.5. Suppose the market price of the mezzanine bond is 20% and the price of the senior bond is 70%, with a resulting weighted average bond price of 65%. The Mark to Market (MTM) loss to the Street as an aggregate investor in the bonds of this RMBS securitization is $\$90 \times (\text{Par} - 70\%) + (\$10 + \$50) \times (\text{Par} - 20\%)$, or \$75, which is 75% of the "tower" (i.e., 75% of the aggregate outstanding balance of the bonds in the securitization). The MTM gain on the CDS "short" positions (the net buyers of CDS protection) is $\$50 \times (\text{Par} - 20\%)$, or \$40, which is 40% of the tower.

Private Sector Subprime Remediation

Subprime remediation is a private-sector initiative to be performed with the encouragement of the government that will eliminate much of the leverage that magnifies the banking system's subprime exposure while reducing the cost of mortgage defaults. The purchase of delinquent loans out of the RMBS, or remediation of the RMBS, would allow participating financial institutions to avoid losses on the group's aggregate exposure to the RMBS in return for taking losses on the underlying loans purchased from the RMBS. The participants would remediate securitizations where the benefit (avoided losses on the aggregate exposure to the RMBS) exceeds the cost (expected losses on the underlying loans) under severely stressed scenarios.

Under standard RMBS documentation, the servicer is allowed to sell delinquent loans to a third party at Par. A consortium of banks that in aggregate have a leveraged exposure to an RMBS securitization could use this mechanism to purchase delinquent loans from a subprime RMBS trust to be serviced outside the securitization. Some important consequences of remediation would be:

1. After being removed from the securitization, mortgages can be more readily modified, including significant write-downs of principal, in order to prevent foreclosures.
2. Because no significant losses are realized within the securitization, bonds will not be written down.
3. MTM losses on the Street's levered exposures to bonds in the securitization will be reversed.
4. MTM gains on speculators' short positions will be reversed.
5. The remediation activity will incur mortgage workout losses expected to be as much as 40% on 2005 vintage subprime loans and as much as 50% on the 2006 vintage.
6. Because losses avoided on the Street's levered exposures are conservatively projected to outweigh losses incurred on mortgage workouts, remediation of levered subprime exposures will result in capital creation for the banking system.
7. The costs of recapitalization through remediation will be shared by the Street (the "longs") and speculators (the "shorts").

Recall the example mentioned above, in which the weighted average bond price of every tranche of a subprime RMBS was 65%. Ignoring any subordination in the form of overcollateralization the expected value of the loan collateral supporting the deal should also be equal to 65%. If loans worth 65% are purchased at 100%, this will produce an expected cost of remediation of 35% (loans purchased at 100% that should be MTM at 65% would result in a cost of 35%). Recall also that the loss implied by the MTM of the street's exposure to the RMBS calculated above was 75%. Avoiding a loss of 75% at a cost of 35% will *result in a gain to financial institutions exposed to the RMBS of 40% (or 75% - 35%) of the tower.*

Financial Statement and Capital Considerations

Many financial institutions have taken enormous mark-to-market losses on U.S. RMBS. While the realized losses on mortgage collateral held by subprime securitizations are still quite low, expected future losses are substantial. The current convention for marking-to-market a bank's RMBS exposure is to calculate the present value of a tranche's projected cash flows, adjusted for expected future losses, at a rate of approximately 20%. Marking to market RMBS exposures given these assumptions (extreme losses and high discount rates) has been the major cause of the erosion in capital of U.S. banks and broker dealers. A contractual agreement among a consortium of banks that commits the banks to purchase delinquent collateral at par from an RMBS servicer *should enable the banks to immediately realize mark-to-market gains on certain RMBS exposures.*

What is Required of Treasury

In order to facilitate large scale remediation, the Treasury should:

1. encourage regulated financial institutions to participate in RMBS remediation
2. give these institutions comfort on possible anti-trust and market-manipulation concerns
3. require participating institutions to take write-downs or provide mortgage insurance sufficient to qualify delinquent borrowers meeting certain criteria to refinance into government-sponsored enterprise (GSE)-style loans

Benefits

Encouraging large scale remediation would have the effect of contributing to the recapitalization of the banking system without requiring additional Government investment. For example, there are 120 subprime securitizations that have a current outstanding of a little over \$35 billion. The market's long exposure to these securitizations is \$73 billion, and most of this exposure is held by the banking system. The estimated mark-to-market of this long exposure is approximately \$23 billion, and the resulting loss is approximately \$50 billion (\$73 billion minus \$23 billion). Large scale remediation would allow the banking system to reverse this loss, at a projected cost of \$10 - \$15 billion in losses on the underlying loans. The resulting gain to financial institutions after marking to market the expected cost of remediation would be approximately \$35 - \$40 billion. Even if participation were limited to as few as six financial institutions, the gain resulting from remediation to this group would be about \$10 billion.

Government Assistance Can Leverage Private Sector Investment

Although remediating \$35 billion of RMBS would result in a significant return of capital to the banking system, it would involve only a small percentage of the total amount of subprime RMBS outstanding. The following three government initiatives would increase the amount of RMBS susceptible to remediation:

1. encourage widespread participation in remediation as mentioned above
2. facilitate refinancing for large numbers of subprime borrowers *current* on existing mortgages
3. purchase delinquent loans from existing securitizations under the TARP program

The senior bonds of later vintages of subprime securitization (2006 and 2007) have not amortized as much as the senior bonds of the earlier vintages (2004 and 2005). The market is currently very pessimistic as to the performance of these senior bonds. Allowing performing borrowers in 2006 and 2007 securitizations to refinance will cause the senior bonds in these vintages to amortize. One consequence of this will be to return principal to investors thereby injecting capital into the banking system. Another result will be to make a greater number of 2006 and 2007 subprime securitizations susceptible to remediation, which will result in a further creation of capital for the banking system at no expense to the U.S. tax payer.

In the following pages we have attached diagrams of Leveraged exposure and remediation as well as an example of the possible accounting treatment of the remediation of a specific RMBS.

Notes:

1. An investor may hold subprime risk in any of the following forms: whole loans, RMBS bonds (or CDS thereon), and through an investment in a tranche of a CDO. In the case of the default of an unsecuritized mortgage (a whole loan), an investor will experience a loss equal to the loss severity. In the case of the default of a securitized mortgage (a loan in an RMBS trust), there may be multiple investors who experience a loss as a result of the default: the holder of the affected cash RMBS bond, the holder of a CDS referencing this bond, and the holder of a tranche of a CDO owning such bonds and/or CDS.

The combined loss to all investors affected by a securitized mortgage default will be a multiple of the loan loss severity equal to:

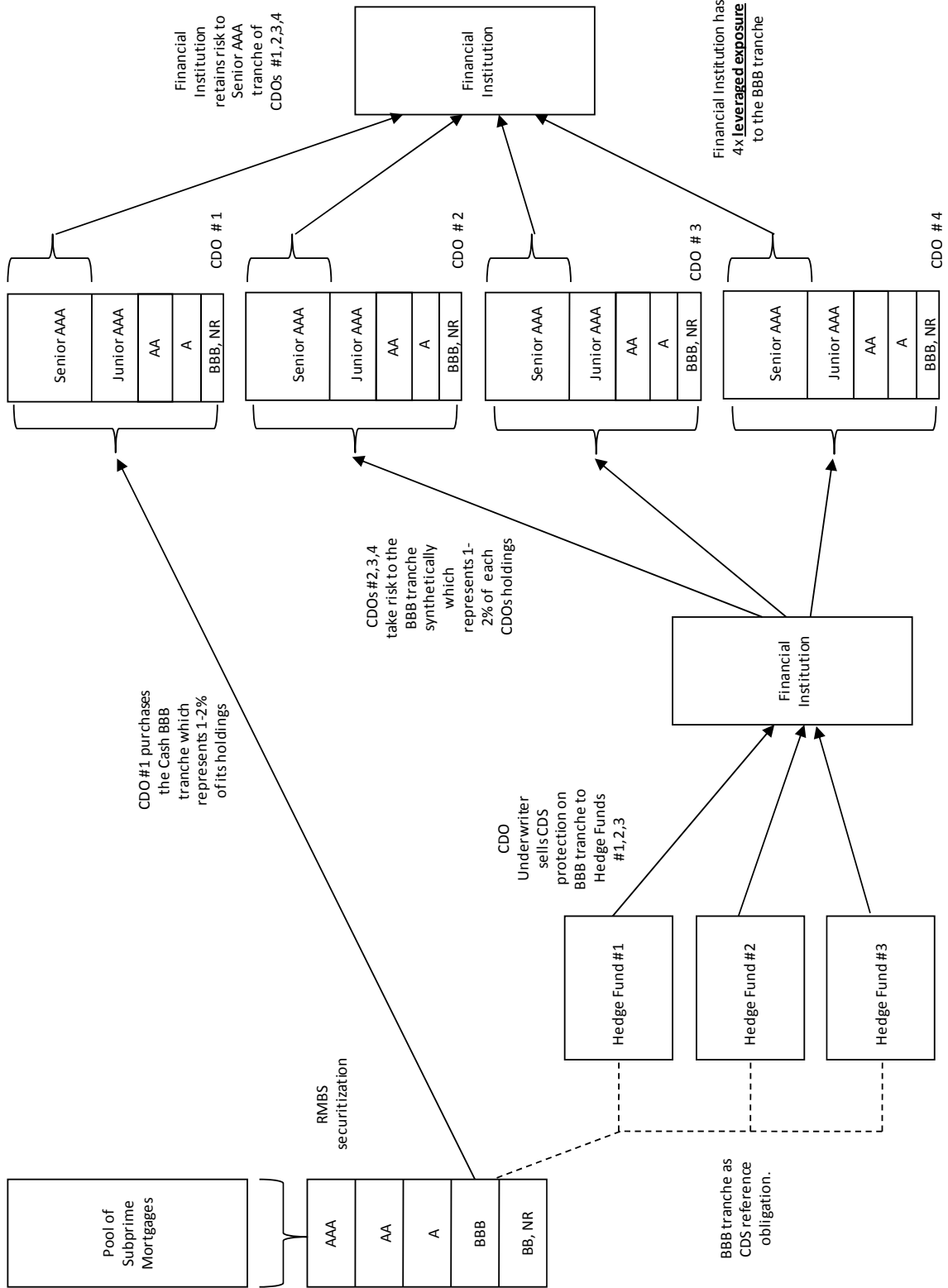
$$\text{Security loss multiple} = 1 + (\text{aggregate affected CDS size}) / (\text{affected RMBS bond size})$$

The potential exposure to loan losses for all investors in all the bond classes of a given RMBS securitization (the "exposure multiple") is equal to:

$$\text{Exposure multiple} = 1 + (\text{aggregate size of all CDS referencing any bond in the securitization}) / (\text{aggregate size of all bonds in the securitization})$$

The Street has a "levered exposure" to any RMBS securitization with an exposure multiple greater than one.

CDS written by CDOs gave rise to leveraged exposure to RMBS



Financial institutions now have direct leveraged exposure to RMBS

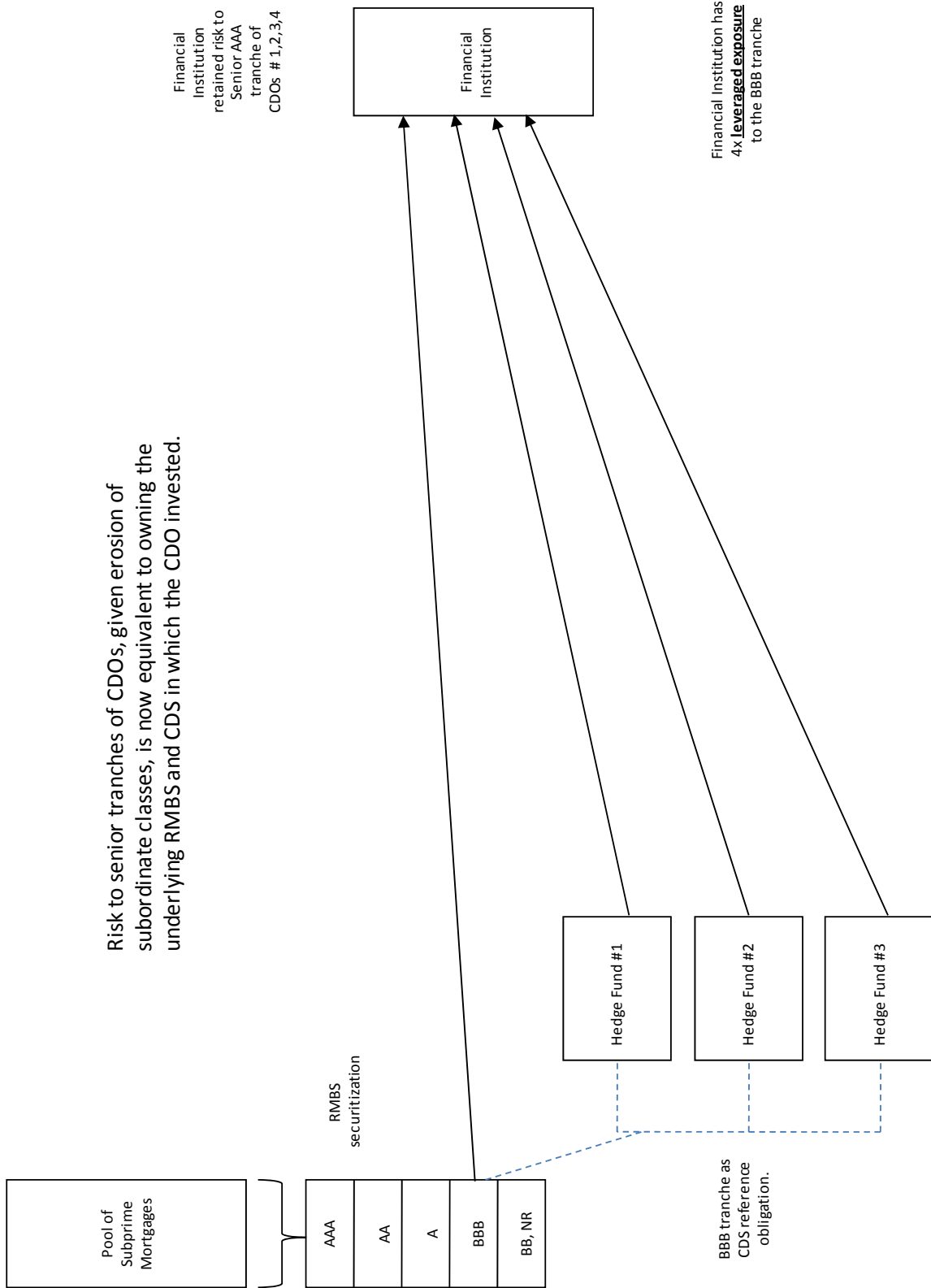
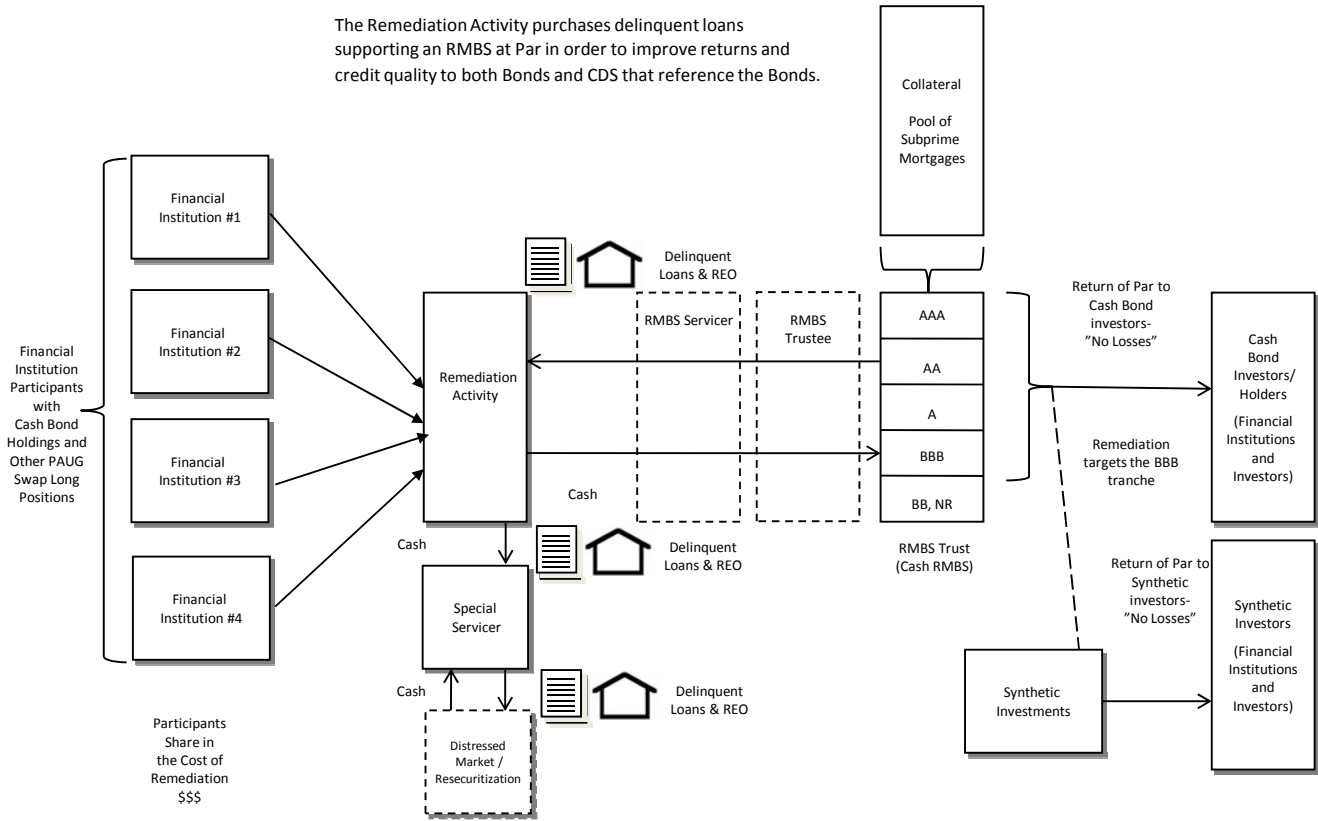
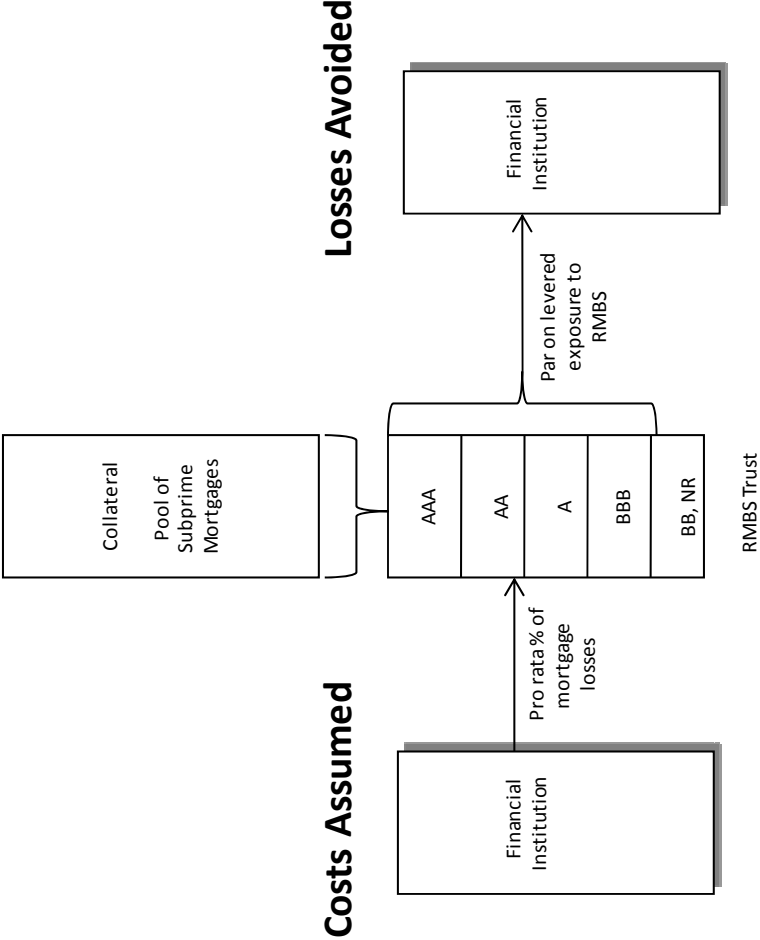


Diagram of Remediation

The Remediation Activity purchases delinquent loans supporting an RMBS at Par in order to improve returns and credit quality to both Bonds and CDS that reference the Bonds.



Economics of remediation to a participating financial institution



The Financial Institution's leveraged exposure to tranches of the RMBS becomes riskless once the Financial Institution commits to remediation and agrees to assume a pro rata share of losses on defaulted mortgages purchased from the RMBS.

Cost/Benefit Analysis of the remediation of a specific RMBS by a group assumed to consist of six major Financial Institutions.

RFC05KS7 remediated by: 6 major Financial Institutions

Class	Original Rating	ABX Mapped Px	Outstanding	Group Exposure	Group Benefit (1-Px) X Exposure	Bank Exposure	Bank Benefit (1-Px) X Exposure	Bank % of Benefit	Group Cost (1-Px) X		Bank Benefit - Bank Cost
									Outstanding	Bank % of Cost	
a2	Aaa	87.14%	27,486,106	-	-	-	-	30%	3,534,713	1,056,908	
a3	Aaa	87.14%	10,388,000	-	-	-	-	30%	1,335,897	399,444	
m1	Aa1	69.97%	14,802,000	3,000,000	900,900	3,000,000	900,900	30%	4,445,041	1,329,104	
m2	Aa2	52.80%	13,202,000	5,500,000	2,596,000	-	-	30%	6,231,344	1,863,223	
m3	Aa3	41.94%	8,001,000	-	-	-	-	30%	4,645,647	1,389,087	
m4	A1	31.07%	7,401,000	-	-	-	-	30%	5,101,263	1,525,320	
m5	A2	20.21%	6,801,000	-	-	-	-	30%	5,426,518	1,622,574	
m6	A3	16.62%	6,401,000	2,000,000	1,667,533	2,000,000	1,667,533	30%	5,336,940	1,595,789	
m7	Baa1	13.04%	5,801,000	2,551,000	2,218,435	-	-	30%	5,044,743	1,508,420	
m8	Baa2	9.45%	5,001,000	67,501,000	61,122,156	10,000,000	9,055,000	30%	4,528,406	1,354,031	
m9	Baa3	8.73%	4,601,000	113,851,000	103,911,808	43,750,000	39,930,625	30%	4,199,333	1,255,635	
Sub Total			109,885,106								
Other subordination (m10 and OC)			12,827,155								
Total			122,712,261	194,403,000	172,416,831		51,554,058		49,829,844	14,899,535	36,654,523
Collateral Performance											
DQ 90 days		6.26%									
Foreclosure		14.11%									
REO		6.72%									

Possible accounting treatment of the impact of remediation of RFC05KS7 on one participant

Tranches	ABX Mapped Px	MTM prior to remediation	MTM @ 100 post remediation	Gain
m1	69.97%	2,099,100.00	3,000,000	900,900
m6	16.62%	332,466.67	2,000,000	1,667,533
m8	9.45%	945,000.00	10,000,000	9,055,000
m9	8.73%	3,819,375.00	43,750,000	39,930,625
Gross MTM Gain on Tranche positions				51,554,058
MTM of remediation obligation				(14,899,535)
Net MTM Gain				36,654,523

CHAPTER 2

IMPROVING THE PRIVATE MULTI-FAMILY PROGRAMS

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

EXECUTIVE SUMMARY

The Federal Government has long played an integral role in the creation and preservation of multi-family housing – particularly for those not served by private-market forces. The U.S Department of Housing and Urban Development (HUD) has had varying degrees of success during its 40-year history and its visibility has fluctuated dramatically under different Administrations. Never has the role of the Department been more critical than it is today.

We stand at the brink of a new era. The Secretary has the opportunity to undertake an aggressive strategy to drive fundamental changes to private multi-family housing programs. The changes, discussed as recommendations in this report, will enable HUD to increase home production in a weakened capital market, expand its role as a thought leader in critical areas of policy, and improve HUD’s internal culture to an entrepreneurial one that embraces the new possibilities for impact the new Administration brings.

For HUD to reaffirm its traditional crucial role as the leader of the private multi-family housing industry, it must act quickly and aggressively with its internal team and other federal and state agencies to develop the necessary capacity and resources.

A. Strategic Premise

Certain actions taken by the Secretary of HUD will have the impact of opening up the development of affordable housing in the current market, enhancing the delivery of essential HUD financing products and programs, and improving the interface between HUD and its partners.

B. Vision

The recommendations discussed in this report are guided by a shared vision for HUD as the policy leader for housing and urban affairs by becoming:

- A key collaborator with the White House, Treasury, Health and Human Services (HHS), Environmental Protection Agency (EPA), Department of Energy, and others in developing policies and programs that break through traditional departmental boundaries;
- A catalyst for and disseminator of successful models;
- A partner with states and cities in using its financing and policy tools effectively; and
- A partner with its private sector program participants.

C. Recommendations

The purpose of this report is to identify policies, programs, and systems that, if employed, would enable HUD to more effectively administer its multi-family housing programs.

Recommendations address both immediate turn-key actions, which would open up markets for affordable housing development in the first 100 days as well as actions that could be taken during the first year or two of the Administration that would enable the Department to become a consistent, proactive partner. Recommendations fall into four categories:

- **Reform Federal Housing Administration (FHA):** Enhance the effectiveness of HUD’s multi-family products by injecting liquidity in the multi-family construction market and improving current multi-family insurance programs;
- **Motivate Investment in Multi-Family Affordable Housing:** Create the National Housing Trust Fund, retool and reform financing programs (including the Low Income Housing Tax Credit [LIHTC]) to enhance liquidity for multi-family housing, and fund multi-family properties stalled in the current capital market;
- **Preserve Affordable Housing:** Take steps to preserve existing affordable housing through a series of administrative, programmatic, and statutory modifications to existing practice, improvement of the Section 8 program, and facilitation of the financing of preservation transactions; and
- **Transform HUD’s Culture:** Inspire transformative change in internal approach and external interface with stakeholders. Dynamic, new leadership and a dramatic process of change at HUD will enable the agency to reassert its appropriate role.

REFORM FHA's PROGRAMS

The housing crisis we are experiencing and the weakened state of Fannie Mae and Freddie Mac in this crisis point directly to the substantially missing and critically important leadership role of FHA in housing finance including both single- and multi-family housing. HUD insurance programs could be the backbone of multi-family finance in the United States in this time of economic stress.

A. First 100 Day Strategy – FHA

Steps must be taken in the short- and medium-term to assure that the Federal Housing Administration can immediately activate its products to facilitate the work of its frequent users and attract participation by new users.

FHA Topic 1: Government National Mortgage Association (GNMA or Ginnie Mae) Construction Loan Securities Purchase Program

Recommendation 1: The Secretary should encourage the Federal Reserve Bank (“the Fed”) to purchase Ginnie Mae Construction Loan (CL) securities at the same rate as the private market is paying for Ginnie Mae Permanent Loan (PL) securities.

As part of the Troubled Assets Relief Program (TARP) and the Fed’s program to buy Fannie Mae, Freddie Mac and Ginnie Mae securities, the Fed could inject liquidity into the multi-family markets, create construction jobs and provide capital for acquiring supplies, materials and equipment by purchasing Ginnie Mae CL securities at the same rate as the private market is paying for Ginnie Mae PL securities.

The ready market for PL securities would set a benchmark for the Fed’s pricing and would allow a private market for CL securities to reemerge when investors’ balance sheets allow their reentry into this credit risk-free market. Once the construction/rehabilitation is completed on these projects (usually 18 to 24 months), the Fed could sell the PL securities and, unless interest rates increase significantly, could make money on the transaction.

Background: The interest rate on Ginnie Mae construction loan securities is significantly higher than on permanent loan securities and the high rates are making most FHA-insured new construction and substantial rehabilitation developments infeasible. Generally, the rate on Ginnie Mae CL securities has been the same as on project loan securities because both are backed by the full faith and credit of the U.S. government and both have been very liquid investments with a ready market of investors. However, in the current market, there are few investors willing to buy and hold the CLs until they convert to a PL security. Most of the previous investors are experiencing balance sheet problems and do not want to accumulate and hold the CLs during the construction period until they convert and can be placed in a Real Estate Mortgage Investment Conduit for sale to permanent investors. This issue has led to price differences of approximately 100 basis points, rendering many projects infeasible.

In a recent survey of mortgage lenders by the Mortgage Bankers Association of America (MBAA), 26 lenders reported that there are currently more than 200 applications in process for FHA insurance for more than \$3.2 billion in mortgage amount (representing approximately 29,000 units) that could go into construction in the next six months if this program were implemented. This would provide much-needed affordable rental housing and healthcare facilities—both preservation of current properties as well as new construction in certain markets. The program would also provide strong economic stimulus in markets across the country as almost 34,000 jobs would be generated quickly and efficiently. The National Association of Home Builders estimates that the development of a typical 100-unit multi-family apartment complex generates 116 new jobs in the construction trades and in companies that supply goods and services integral to the development of this housing.

B. Mid-Term Strategy – FHA

FHA Topic 2: Reenergize Multi-family Insurance Programs

There are a number of administrative and legislative actions that the Task Force strongly recommends the Secretary and FHA Commissioner implement in 2009 that will enable it to more effectively administer the multi-family insurance program. These adjustments are intended to address inefficiencies and minor imperfections in current insurance programs.

Addendum 2.1 details a list of recommended adjustments to current FHA practices and regulations. Enacting these adjustments, all of which have broad support in the industry, would enable the incoming HUD leadership team to make FHA products much more efficient and productive for the lending and development industries.

Recommendations are divided into administrative and legislative changes that, individually and collectively, will improve HUD programs, which, in our view, are stronger in their design than execution. The fundamental premise behind the recommendations is that HUD can be a far more effective player in the multi-family housing industry without burdening the federal budget and without taking inappropriate insurance risks.

We encourage the incoming leadership team to review each of the changes to multi-family insurance programs by reviewing each of the recommended changes in Addendum 2.1. In brief these administrative and legislative recommendations are:

Administrative Recommendations

Recommendation 2.1: Make it a Federal responsibility to produce a Federal housing program.

Recommendation 2.2: Correct Davis-Bacon wages.

Recommendation 2.3: Restore project-based Section 8 contracts.

Recommendation 2.4: Authorize automatic prior participation clearance, after application and approval, for frequent participants in HUD programs.

Recommendation 2.5: Encourage preservation of affordable housing.

Recommendation 2.6: Assure quality of buyers of HUD troubled properties.

Recommendation 2.7: Allow contingencies for new construction.

Recommendation 2.8: Allow the option of balloon mortgages and lower floaters.

Recommendation 2.9: Correct the annual contribution to reserves for replacement to \$250 per unit per year.

Recommendation 2.10: Keep to the Multifamily Accelerated Processing (MAP) time frames.

Recommendation 2.11: Release cash flow monthly.

Recommendation 2.12: Allow more retail/commercial space in Section 221d properties.

Recommendation 2.13: Define elderly as age 55.

Recommendation 2.14: Correct Section 231 underwriting.

Recommendation 2.15: Modernize ground leases.

Recommendation 2.16: Correct Master Lease underwriting requirements.

Recommendation 2.17: Allow Firm Commitment applications with less than 100% plans, specs, and costs.

Recommendation 2.18: Correct mortgage insurance premium (MIP) for Section 223f.

Recommendation 2.19: Allow MAP underwriting for Section 241 loans.

Recommendation 2.20: Allow meal service in Section 231 properties.

Recommendation 2.21: Allow construction on sites deemed residentially safe by the States.

Recommendation 2.22: Allow non-profits to benefit from payment in lieu of taxes (PILOTS).

Legislative Recommendations

Recommendation 3.1: Set aside mortgage insurance premiums as a Housing Trust Fund.

Recommendation 3.3: Increase per unit statutory limits by a construction inflation factor.

MOTIVATE INVESTMENT IN MULTI-FAMILY AFFORDABLE HOUSING

A. First 100 Day Strategy – Motivate Investment

Motivate Investment Topic 1: Allocate Federal Funds to Fund Stalled LIHTC Properties

Recommendation 4: Advocate the allocation of \$5 billion in specially-appropriated Home Investment Partnerships (HOME) or TARP funds as gap financing to State LIHTC-allocated agencies for stalled projects.

Background: The credit crunch has made the financing of tax credit-financed multi-family housing extremely difficult in the current environment. Developers who have been allocated LIHTCs have been unable to raise sufficient debt and equity for their properties. In the past year, the value of tax credits has decreased by 25% or more, construction costs and operating costs have increased, incomes have stagnated or decreased, and interest rates remain high. All of these factors taken together have contributed to many tax credit allocations being returned or developments simply not moving forward, awaiting additional subsidy, lower interest rates or some other method of bridging the gap.

Gap funds invested through state allocation agencies could fill financing gaps and start LIHTC projects immediately before the investment industry recovers. In the event HOME funds are unused, matching fund requirements should be waived and LIHTC rules (e.g., rent and income) should be followed.²⁶

Motivate Investment Topic 2: Facilitate the Availability of Financing for LIHTC Properties

Recommendation 5: Pursue one of the following two options to address debt service costs:

- As part of TARP and the Treasury's proposed rate buy-down program for single-family loans, Treasury could purchase multi-family loans where the property is assisted through low income housing tax credits at an interest rate. Treasury could issue 15-year debt at current rates and purchase Fannie Mae, Freddie Mac or Ginnie Mae securities backed by the loans, earning the interest rate spread for 15 years and then selling any remaining loans that have not refinanced at the end of the 15-year period. There would be some cost to the government, depending on the number of loans not refinanced during the 15 years and the level of interest rates at the end of 15 years.

²⁶ This Task Force is supportive of Representative Frank's call for an additional \$5 billion of Treasury funds to be invested in the purchase of low income housing tax credits that have no current marketability.

OR

- HUD could launch a new Ginnie Mae Tandem program whereby Ginnie Mae would purchase FHA-insured loans at a 4.5% interest rate and hold them until maturity or until the market is such that they could sell them at a reasonable price.

Background: To make these loans feasible, new tax credit investors are being cultivated, additional soft debt or grants are being sought, construction cost savings are being explored, and all operating costs are being closely scrutinized.

In a recent survey of mortgage lenders by the MBAA, the 26 lenders responding reported that there are currently more than 25 applications in process for FHA insurance with low income housing tax credits for more than \$125 million in mortgage amount (representing approximately 4100 units) that could go into construction in the next 6 months, if a 4.5% interest rate could be assured. This would provide much needed affordable rental housing; the National Association of Home Builders estimates it would produce more than 4,700 jobs.

Motivate Investment Topic 3: Unlock the Housing Bond Program.²⁷

In the current market, there has been limited demand for Housing Bonds. The lack of liquidity has frozen the utilization of state and federal products. The following steps must be taken by the incoming HUD leadership to encourage associated entities within the federal government to support the improvement of Housing Bond Programs.

Recommendation 6.1: Encourage Treasury to use TARP funds or other resources available to purchase long-term fixed-rate Housing Bonds at reasonable rates, which will establish the market and draw in other investors.

Recommendation 6.2: Encourage Treasury and the Federal Reserve to establish liquidity facilities for: Housing Finance Agency (HFA) Variable Rate Demand (VRD) loans, to attract buyers for this short-term debt by pledging to step in and purchase it if there are no other buyers when its terms call for it to be remarketed; and for HFA long-term, fixed-rate Housing Bonds, to attract investors by making funds available to them to purchase these bonds.

Recommendation 6.3: Encourage the Federal Reserve to condition its GSE debt and mortgage-backed securities (MBS) purchases on GSE commitments to use a portion of the funds they receive to buy HFA Housing Bonds and provide liquidity to HFAs to support their lending programs.²⁸

Recommendation 6.4: Engage Fannie Mae and Freddie Mac to advance their affordable housing mission by supporting HFAs by buying their Housing Bonds and providing them liquidity through loan purchases, including FHA-insured loans, on reasonable terms and other means. Support these activities by increasing the GSEs' debt ceilings, relaxing the limit on the amount of their assets they can invest in tax-exempt bonds (the so-called 2 percent De Minimis Rule), and awarding them affordable housing goal credit for these activities.

Recommendation 6.5: Encourage the Federal Home Loan Banks to advance their affordable housing mission by providing HFAs liquidity on reasonable terms.

Recommendation 6.6: Change the Housing Bond law²⁹, so as not to require issuers to designate housing purposes when they carry forward unused bond authority from one year to another, and extend HERA's

²⁷ From NCSHA Economic Recovery Priorities White Paper.

²⁸ Traditionally, Fannie Mae was the primary purchaser of 40-year tax-exempt bonds from the HFA's, but no longer need tax-exempt income. This recommendation would bring purchasers back into the 40-year tax-exempt bond market. The GSEs could hold the bonds and resell them when the market is more stable as with tax credits.

²⁹ Section 142(d) of the Internal Revenue Code of 1986 (Code) as amended allows for the issuance of tax-exempt multi-family housing bonds to be bought by private parties. These bonds may be accompanied by 4% LIHTCs under Section 42 of the Code. Section 145 of the Code permits issuance of tax-exempt bonds to finance multi-family housing owned by qualified non-profit corporations.

AMT exemption to prior-year Housing Bond authority carried forward to 2009 or future years and to bonds issued to refund prior-year Housing Bonds.

Recommendation 6.7: Utilize the HFA delivery system to ensure that any forthcoming Treasury and Federal Reserve mortgage rate buy-down initiative reaches lower-income families HFAs to successfully serve and provide a further interest rate advantage to those families.

Recommendation 6.8: Eliminate the so-called Mortgage Revenue Bond (MRB) Ten-Year Rule that requires payments on mortgages financed with Housing Bonds outstanding for more than ten years to be used to redeem bonds rather than to make new mortgages.

Recommendation 6.9: Expand bank interest in municipal bonds by increasing the bank qualified issuance limit.

*Motivate Investment Topic 4: Structural Changes to the LIHTC Program*³⁰

The Low-Income Housing Tax Credit program has been the most important driver for affordable rental housing over the past twenty years. Discussed below are targeted adjustments, recommended by nearly all within the industry, that would open streams of equity and capital into new development by encouraging former and new investors back into the market.

Recommendation 7: HUD should support efforts to include provisions in a stimulus package that would revive the LIHTC equity market. Proposals currently under discussion include:

1. *Make LIHTCs refundable to arms-length investors (for a two- or three-year period).* Make the LIHTC refundable for arm's length investments made by publicly traded, widely held C-corporations in projects placed in service starting January 1, 2009 and receiving tax credit allocations from states by December 31, 2010. Investors in qualifying projects that do not have sufficient tax liability in any year of the tax credit period would receive a cash refund. Sophisticated corporate investors provide business discipline essential to the LIHTC's success. Refundability should not be available to developers or individual investors.
2. *Extend "carrybacks" from one to five years.* Allow LIHTCs to be "carried back" so investors can offset taxable income from prior years. Under Section 39 of the Code, most business credits, including LIHTCs, may be carried back for one year and carried forward for 20 years except for the marginal oil and gas well production credit, which may be carried back for five years. Until the Taxpayer Relief Act of 1997, the Code permitted a three-year carryback for business credits. A lengthened carryback rule would contribute to increased investment activity in two ways.

First, investors would know that if their tax liability were to decrease and they were unable to use future year credits, they could be used in any of five prior tax years. Profitable companies, uncertain about their tax liability in coming years, would find this far more attractive.

Second, in the current environment companies without current tax liability may begin to sell their existing portfolios at substantially discounted prices. Active investors, sensing the opportunity to purchase these credits at below-market prices, have declined making new investments, further exacerbating an already depressed market. The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, has stated publicly that the GSEs will not make "wholesale" dispositions of their portfolios, but even a partial sale of their very substantial holdings would interfere with raising new capital for new properties. A five-year carryback for these companies and others without current tax liability would encourage such taxpayers to use their credits in prior years when they had tax liability. Presumably, they would choose to use credits where they would receive a dollar-for-dollar return from Treasury rather than sell their credits for a far lesser amount.

³⁰ Proposals 1 and 2 under Recommendation 7 provided by Affordable Housing Tax Credit Coalition (December 2008).

Housing and Economic Recovery Act of 2008 (HERA) permits LIHTCs to be used against alternative minimum tax (AMT) liability, effective for properties placed in service after 2007. The revised carryback rule should permit these LIHTCs to be used in the prior five-year period. In addition, we propose that LIHTCs arising from properties placed in service before 2008 also be allowed against AMT liability during this period.

3. *Extend Special Gulf Opportunity Zone (GO Zone) Incentives through 2012* HUD should join each of the State's in the GO Zone and support the extension by Congress of the completion deadline for GO Zone LIHTC and bonus depreciation until December 31, 2012. Stalled LIHTC developments in the GO Zone depend on special incentives that require project completion by 2010. This deadline is not realistic under current market conditions.

B. Mid-Term Strategy – Motivate Investment

Motivate Investment Topic 5: The National Housing Trust Fund (NHTF)

Background: An important part of restoring HUD's leadership of the U.S multi-family housing sector is for HUD to expand housing options for those with the fewest choices. In the last 20 years, HUD's role has diminished to oversight of the dwindling supply of federally assisted housing, having relinquished responsibility for new development to the LIHTC program, administered by the Department of Treasury. Even while HUD periodically examines "worst case housing needs," thus documenting the shortage of rental homes for the lowest income households, HUD's role in solving the most serious housing needs is limited to the 202 and 811 programs and 30% of the McKinney Homeless Assistance programs. Extremely low income households (30% area median income [AMI] or less) are the only income group for whom there is an absolute shortage of rental homes they can afford (9 million households and 6.2 million rental homes).

The state of low income housing today is a classic example of policy, not demand, driving practice. Since the primary resource for low income housing development is the LIHTC with its specific income targeting requirements, housing developers have gained expertise in building housing that serves the people at the 50-60% AMI level. Only when coupled with operating cost resources, do new LIHTC properties help fill the gap. LIHTC developers have established a model that works and in the absence of new policy that incentivizes them to create new models, this is what they will continue to do.

The NHTF was established to meet the demand for rental homes affordable for extremely low-income households, to incentivize new models. The NHTF is a new program to be administered by HUD. Funding will be distributed to states by formula based on need. The states will make grants to capable developers, who will submit applications to the designated state agency. At least 90% of the funds must be used for rental homes and at least 75% of the rental homes must be affordable to extremely low-income households. Most NHTF grants are expected to be used in conjunction with LIHTCs and other production resources so that a portion of units in new development will be more deeply targeted.

NHTF grants can also be used for preservation and rehabilitation of rental homes that meet the income targeting criteria.

Recommendation 8.1: Expedite the completion of the NHTF regulations. The NHTF statute requires that HUD complete the regulations for the distribution formula by July 30, 2009. HUD staff expects to have all regulations ready by that date. Earlier issuing of the regulations may be possible.

Recommendation 8.2: Require that regulations mandate that all homes produced or preserved using NHTF dollars meet all "green" standards.

Recommendation 8.3: Assure that the economic recovery package includes the requested initial capitalization amount for the NHTF of \$10 billion, which has been requested to be included in the economic recovery package. The challenge will be to solidify sufficient funding for the NHTF for it to produce on the scale that is necessary to fill the gap. The goal is 1.5 million units produced or preserved over 10 years.

Recommendation 8.4: Make 100,000 new project-based vouchers available to be a part of the package to be distributed by the states for use with NHTF units that need additional operating subsidy.

Recommendation 8.5: Initial funding for the NHTF was to have come from contributions from Fannie Mae and Freddie Mac, but has been temporarily suspended due to the current financial crisis at the government-sponsored enterprises (GSEs). Other potential dedicated sources of revenue are various FHA revenue streams. Several others are in development. Securing dedicated sources of funding necessary to produce, preserve, or rehabilitate 1.5 million rental homes affordable to extremely low-income households should be a top priority for the new HUD Secretary in his first two years.

Motivate Investment Topic 6: Improved Coordination Between HUD and LIHTC Program

For over two decades, the LIHTC program has had a remarkably successful track record in combining private and public investment in the creation and preservation of approximately 2,000,000 units of affordable, rental housing.

Nevertheless, users of the program are often daunted by its complexity. Others observe that the tax credit program, absent additional government subsidies, does not provide sufficient capital to fund the production or preservation of housing for households earning less than 30% of income. Still others are concerned that the low-income housing tax credit, as currently structured, is difficult to use in mixed-finance or middle-income housing.

The Department should, over time, become more conversant with the existing tax credit program and request that current stakeholders be consulted on how to make the program less complex. In particular, HUD should consider how its own subsidy and insurance programs can make the credit become more useful in the creation and/or preservation of very low- and middle-income housing.

Recommendation 9: Consider how HUD's programs can make the LIHTC more efficient and useful for low- and middle-income households and for mixed-finance properties.

PRESERVATION OF AFFORDABLE HOUSING

The large and critical stock of existing affordable properties is controlled by long-term stewards from the non-profit and for-profit industry who keep the housing affordable and, to the extent of financial support, maximize the supportive services. Policies that support these owners and encourage the preservation of this housing build a stronger capital base and allow them to deploy their resources flexibly. This introduction would be more helpful if it were extended to include a description of what your recommendations are trying to fix and how generally they will ameliorate any existing inadequacies.

A. First 100 Days Strategy – Preservation

Preservation Topic 1: Strengthen Project-Based Section 8 Contracts

Background: Project-based Section 8 is an important tool for borrowers, tenants, and local jurisdictions to provide quality affordable housing. The affordable housing investment community is unable to make investments in rural communities or in severely distressed communities without rental subsidy, even in the absence of must-pay debt in the transaction.

The current program needs significant improvements. It should be easier to move project-based contracts from failing projects to new, better located projects. Payments, of course, need to be paid reliably without months-long gaps. Section 8 contracts should be extended at least 20 years or to the affordability period for tax credit projects. Even with 20-year contracts subject to annual appropriation, HUD actions over recent years in curtailing Section 8 funding necessitate more to enable lenders and investors to finance Section 8 assisted housing. Current market constraints could be met by a commitment upon signing of a Section 8 contract – and not subject to annual appropriation – for a

funding of two times the annual contract amount to a project to enable its transition to tax credit rents at any point prior to the 20-year life of the contract should HUD cease to provide continuing funding.

Revised Section 15.8 of the Section 8 renewal guide should be rescinded. It requires that non-profit general partners in a tax credit transaction be limited to the lower of market or tax credit rents, which thus reduces any insured mortgage.

Recommendation 10: Make 20-year project-based Section 8 contracts available again and reliably funded.

B. Mid-Term Strategy – Preservation

Preservation Topic 2: Facilitate Financing of Preservation Transactions

Background: One reason that HUD 202 refinances and other preservation deals are often not viable is that, when financed with 4% LIHTCs and tax-exempt bonds, there is not enough capital for the comprehensive rehabilitation needed to fully recapitalize the deals. Too much of the refinance is dedicated to paying off the existing HUD mortgage

Recommendation 11: Make soft sources available to preservation transactions and make it easier to subordinate existing HUD debt to improve viability of such projects refinances.

Preservation Topic 3: Administrative Actions to Encourage Preservation of Affordable Housing

There are a number of administrative and legislative actions that the working group strongly recommends the incoming Administration consider in its first year that will strongly encourage the preservation of affordable housing. We have included an extended list of important recommendations in Addendum 2.2 to further advise the incoming HUD leadership team.

The recommendation, considered together, will bring a department-wide focus to the preservation of affordable housing. The detailed discussion in Addendum 2.2 of the recommendations outlines the steps the new leadership must take to set this priority. In brief, these administration and legislation recommendations are:

Administrative Recommendations:

Recommendation 12.1: Model leadership on preservation at every level of HUD.

Recommendation 12.2: Solicit input on policy changes and opportunities to improve preservation practices.

Recommendation 12.3: Approve rent increases for owners of Section 221(d), Section 236, and Section 202 elderly properties.

Recommendation 12.4: Revise regulations and HUD handbook to allow project income distributions to non-profit owners on the same basis as limited distribution for-profit owners.

Recommendation 12.5: Use existing discretion to provide rent increases, when authorized and justified by the market, to encourage recapitalization and continued owner participation, and the transfer to non-profits of at-risk properties.

Recommendation 12.6: Honor the non-profit incentives in the Mark to Market program and end the practice of requiring repayment of mortgage restructuring notes as a percentage of the developer fee earned by a non-profit purchaser.

Recommendation 12.7: By general policy, provide tenant protection vouchers on a one-for-one replacement basis for all lost or converted affordable units, not just occupied units.

Recommendation 12.8: By general policy, make 20 year Housing Assistance Payment (HAP) contracts, subject to appropriations, available in preservation sales and refinancings, regardless of when the current contract will expire.

Recommendation 12.9: By general policy, provide the tools to preserve state-HFA financed projects.

Recommendation 12.10: By general policy, permit the assumption and subordination of Section 202 loans, Flexible Subsidy loans, and other loans where warranted by the needs of the property or residents and reverse the discredited OGC opinion limiting assumption of Section 202 loans by a non-profit.

Recommendation 12.11: Revise the Section 202 Use Agreement required in preservation sales or refinancing, which now bars the owner from charging rents above 30% of income even when Section 8 is not renewed or funds are not appropriated.

Recommendation 12.12: By general policy, but on a case-by-case basis in field offices, allow affiliated owners in the same state to merge or cross-collateralize loans in preservation sales or refinancings of small properties and Section 202 properties.

Recommendation 12.13: By general policy, but on a case-by-case basis, empower field offices to determine that there are chronic vacancies in the efficiencies of a particular property and allow the units to be combined and reduced and any excess Section 8 project-based assistance be transferred.

Recommendation 12.14: Remove the 7.5% ceiling on secondary seller financing in a preservation sale or refinancing using Section 223(f) insurance.

Recommendation 12.15: Revive cities' right of first refusal for disposition sales by interpreting the Deficit Reduction Act of 2005 to allow consideration of repair or rehabilitation costs in determining market values for HUD-owned buildings and HUD-held loans.

Recommendation 12.16: By general policy, but subject to case-by-case review in field offices, allow the use of residual receipts for rehabilitation projects in cases where residual receipts are held.

Recommendation 12.17: By general policy, but on a case-by-case basis in field offices, allow owners to transfer residual receipts and replacement reserves from one property to another property owned by an affiliate where necessary.

Recommendation 12.18: By general policy, implemented by the field offices, exercise its affirmative obligation under Section 250(a) to make sure that prepayments are not allowed where it will result in the loss of necessary affordable housing.

Recommendation 12.19: Use the authority conferred by Section 215 of the FY 2008 HUD Appropriations Act and Section 8bb to allow owners to transfer Section 8 authority to other properties when a property is obsolete.

Recommendation 12.20: By general policy, but on case-by-case basis in field offices, in the context of a preservation transaction, continue paying Interest Reduction Payments in their entirety, notwithstanding a reduction in total units, if such a reduction is warranted.

Recommendation 12.21: By general policy, direct field offices to encourage and support preservation purchasers willing to take over distressed properties by allowing them time to seek capital for rehabilitation rather than attempt to force immediate repairs and by providing appropriate accommodation in the Real Estate Assessment Center (REAC) and Transfer of Physical Assets (TPA) processes.

Recommendation 12.22: Ensure that rent increase requests are processed at or near the time of recapitalization, whether or not related to recapitalization, in the manner provided under HUD's current handbooks and procedures.

Recommendation 12.23: Regularly provide updated information on HUD’s public website about recent REAC scores, opt-out notices, and mortgage prepayment requests, and link this information to the existing database on HUD-assisted rental properties.

Legislative Recommendations:

Recommendation 13.1: Seek legislation to create a special type of project-based assistance intended specifically to promote the acquisition/rehab or refinancing by qualified preservation owners of properties with maturing mortgages and no or partial rental assistance.

Recommendation 13.2: Seek legislation to permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

Recommendation 13.3: Seek legislation to permit an owner to convert such assistance, which is not renewable, to Section 8 assistance, which is renewable.

Recommendation 13.4: Permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

Recommendation 13.5: Seek legislation to make 20-year, Sec. 8 contracts (subject to annual appropriations) available upon request to qualified preservation owners who wish to acquire/rehab or refinance these properties.

Preservation Topic 4: Supportive Housing

Background: Based on existing successful models that combine affordable housing with extended services for low- and middle-income families generally and populations with specific needs (e.g. veterans, the homeless), it is time the new Congress and Federal Administration take the next step and explore opportunities to scale-up existing, successful programs to include a much larger population. Successful models have not only increased family stability and reduced poverty by working with families and individuals to build human capital and increase their financial assets but have, as is well documented, reduced costs to public systems including emergency and long term health care, the penitentiary and welfare system. Further, affordable housing providers have documented decreases in tenant turnover rates and vandalism to properties, thus reducing the overall operating costs to affordable housing providers and HUD.

Key services may include financial literacy to improve credit scores and savings; adult education attainment, jobs skills training and job placement to increase income as well as education enrichment programs for children to ensure school success and completion. Yet, in order for a range and diversity of programs to be made available to residents with varying interest and degrees of need, it is time to reconceptualize how services are provided and explore moving toward strategic partnerships working among the federal agencies who define the scope of various programs, the local agencies who administer the programs and the housing providers who provide the platform from which residents can access services.

The Obama Administration has emphasized the Promise Neighborhood model to provide comprehensive and integrated supports to poor families, especially children. It can reshape large scale affordable housing efforts by funding a series of new developments co-located with strong neighborhood-based organizations with highly developed and effective human development programs. HUD’s leadership in an effort grounded in HUD-assisted communities could be complimented by efforts initiated from other focal points – whether they be educational environments supported through the Department of Education or human service providers support through the Department of Health and Human Services.

Recommendation 14.1: Create incentives for affordable housing providers by creating the funding necessary to provide expanded services through an enhanced LIHTC program and/or expand the Section 8 Housing Grant and Rental Assistance Contract.

Recommendation 14.2: Incentivize service agencies, local government and affordable housing providers to partner with one another, through federal legislation and appropriations targeted specifically at housing providers and local agencies who work together to meet resident needs, reduce resident deprivation and demonstrate clear outcomes.

Recommendation 14.3: Make necessary changes to and increase funding resources for veterans generally and homeless veterans specifically in addition to similar changes to the HUD 811 program for the disabled.

Recommendation 14.4: Explore the possibilities for “charter housing,” designed for specific populations that face common issues and have common opportunities. Engage social entrepreneurs to bring to that housing their transformative ideas about education, health care, microenterprise and the like and secure the commitment and active participation of residents.

Recommendation 14.5: HUD would run a competition and select for funding up to 10 recently completed HUD-assisted affordable and mixed-income communities to participate in the Promise Neighborhood initiative. One promising focal point could be some of the several hundred HOPE VI properties. A second effort would involve selecting ten communities for funding where there is a strong Harlem Children’s Zone-like program mix and capacity and where a residential platform could add a critical component to achieving long-term success.

CULTURE OF HOUSING AND URBAN DEVELOPMENT TERMS

HUD has a proud history. However, over recent decades, the Department has become an inconsistent and unpredictable partner. Despite the dedication of many long-time HUD employees, it has become commonplace for its one-time stalwart supporters – non-profit and mission-driven for-profit developers, state and local governments, advocates, etc. – to blame HUD for blocking innovative affordable housing solutions. Further, decision-making at the 51 Hubs is often pushed up the chain of command to unusually high levels inside the Department. The resulting delay frustrates HUD’s key constituents and makes it difficult, if not impossible, for the FHA Commissioner and Assistant Secretaries to do their real jobs.

The common result of this dynamic is once-motivated staff losing the ability and, in some cases, impulse to be effective and efficient partners. The incoming leadership of HUD must take immediate steps to improve morale and encourage positive decision-making in the Field Offices. It must also develop a means of gathering feedback on performance and suggestions for process improvement to develop a culture of continuous learning.

There is a critical role for HUD to design the vehicles to meet the needs of the multi-family affordable housing development industry, allocating the resources to fund the programs and overseeing their implementation. Delegating all of these roles to state and local governments represents a major abdication of the federal role in assuring decent housing for all Americans. HUD staff must be empowered to lead this effort.

A. Mid-Term Strategy – HUD Culture

Culture Topic 1: Field Office Staff Outlook and Attitude

Background: HUD has many bright, dedicated, and talented field-office staff. Some are already active readers of the MAP Guide and other HUD handbooks and believe that the production of rental housing for all income levels and urban revitalization are critical responsibilities of the federal government. If a transaction involves sensible risk, they will allow underwriting that encourages the development unless some handbook, regulation, or statute prohibits some modest change to standard underwriting. Or, they will find a sensible way to approve a handbook waiver. If the handbook doesn't say you can't, then you can.

Others only follow underwriting procedures that are specifically permitted in the handbooks, regulations, and statute. If the handbook doesn't say you can, then you can't. Staff needs to be encouraged to have a sense of reasonable real estate risk, or reasonable mitigation of risk, and be encouraged to support development. If they are shown that taking

risks, encouraging urban and suburban development, and providing rental housing are as important to their personal careers as protecting themselves from negative feedback, if those who take risks are professionally rewarded or publicly congratulated, morale will improve and production will follow.

In addition, a team from HUD Central, willing to meet in the field offices with stakeholders and staff (separately and together), could help promote resolution of industry problems.

If all handbook sections were marked to show which provisions are statutory (changed only by Congress), regulatory (waived by the Federal Housing Commissioner), or handbook guidance (waived at the field office level or HUD Central level), field-office staff would know how far their decision-making authority extended.

Recommendation 15: Address staff morale and positive decision-making among field office staff.

Culture Topic 2: Continuous Feedback and Commitment to Improvement

Background: The healthcare underwriters at HUD have been grouped into a new program called Section 232 LEAN which is modeled after the Toyota model of continuous improvement. They encourage regular, specific feedback, and questions from lenders and borrowers.

Multi-family production and asset management would benefit from a similar approach. The ability to email or post suggestions that would be rapidly answered by a responsive decision-maker on how to improve the process, would be very helpful. A feedback system works now, with industry meetings and visits back and forth between HUD staff and stakeholders, but a commitment to rapid continuous improvement is missing at HUD Central for the multi-family programs. The clearance process for minor improvements takes months and years.

Recommendation 16: Solicit continuous feedback from stakeholders and reinforce commitment from HUD central to improvement.

ADDENDUM 2.1

MID-TERM STRATEGY – Reform the Federal Housing Administration (FHA) Recommendations

FHA Topic 2: Reenergize Multi-Family Insurance Programs

Administrative Recommendations

Recommendation 2.1: Make it a Federal responsibility to produce a Federal housing program.

The industry occasionally speculates about devolving all the U.S. Department of Housing and Urban Development (HUD) multi-family insurance programs down to the states for implementation. The assumption is that State agencies are less encumbered by a large bureaucracy and can deliver housing more quickly. Experience with the low-income housing tax credit program indicates that, for many States, neither of these assumptions is true. The country has 50 different ways to allocate tax credits and tax-exempt bonds. The programs are frequently slow, cumbersome, and fraught with political considerations. Developers, lenders, and syndicators who work in more than one state have multiple application requirements to learn. Some states require that their allocation of federal tax credits or federal tax-exempt bonds be given to borrowers who also use their State debt programs, thus becoming expensive sole-source providers. States should be prohibited from restricting the use of federal resources to projects using State debt or credit enhancement. The country needs one, consistent federal multi-family housing delivery system, housed at HUD. HUD's field offices are in place and should be improved not abandoned. The mortgage bankers who specialize in HUD-insured mortgages represent a large, well-informed industry already at work promoting the HUD programs and should be viewed as an important asset.

Recommendation 2.2: Correct Davis-Bacon wages.

All HUD insurance programs for new construction or substantial rehabilitation require payment of Davis-Bacon wages. Davis-Bacon wages are supposed to be the prevailing wages paid in the market. The Labor Department's method of collecting data relies on paper surveys frequently completed by union representatives. The results tend to skew wages rates toward union scale and do not accurately reflect wages paid in the wider market. Nevertheless, residential wage rates paid for buildings for four or fewer stories frequently do reflect actual wages paid in the market. The problem arises at the Labor Department's definition of commercial buildings at five or more stories. Local jurisdictions in the Mid-Atlantic region, for example, now define residential buildings, allowing less expensive stick-built construction, as five or fewer stories. Residential wage rates should apply to all new construction of five or fewer stories and to all substantial rehabilitation of buildings of any height. In addition, ancillary facilities including residential parking garages of any cost and retail/commercial space costing less than 20% of total project cost should be allowed at the wage rates of the residential part of the project.

Recommendation 2.3: Restore project-based Section 8 contracts.

Project-based Section 8 contracts need to be available again and reliably funded. Project-based Section 8 is an important tool for borrowers, tenants, and local jurisdictions to provide quality affordable housing. The current program also needs a few improvements. It should be easier to move project-based contracts from failing projects to new, better located projects. Payments, of course, need to be paid reliably without months-long gaps. Section 8 contracts should be extended at least 20 years or to the affordability period for tax credit projects. With confidence that Section 8 will be available, subject only to annual appropriations, syndicators for tax credit transactions would probably be confident enough to allow underwriting at the market rent allowed by Section 8, even if market rent is higher than tax credit rents. This “overhang” is used to underwrite FHA-insured mortgages and is an important source for tax credit transactions. Revised Section 15.8 of the Section 8 renewal guide should be rescinded. It requires that non-profit general partners in a tax credit transaction be limited to the lower of market or tax credit rents, which thus reduces any insured mortgage.

Recommendation 2.4: Authorize automatic prior participation clearance, after application and approval, for frequent participants in HUD programs.

The project inspection and participation clearance processes at HUD have become enormously bureaucratic and cumbersome and have had the effect of making participation in HUD financing programs much more difficult for all firms and particularly those with substantial holdings and experience with the department. The “gotcha” mentality that often raises a field office staff disagreement to a delay in processing further transactions for a HUD user is totally dysfunctional. HUD should establish a procedure for annual authorization of frequent participants in HUD programs and automatic clearance for each transaction after approval of that annual application for the following year. This process should be carried out in Washington. HUD should also set a 3-tier limit to the number of organizational tiers that must complete the Form 2530, establish a set of timelines to streamline the 2530 process and assign to each local 2530 application one field agent who is responsible for processing that application through both the field office and the headquarters review.

Recommendation 2.5: Encourage preservation of affordable housing.

By general policy, implemented by the field offices, HUD should use its regulatory and financial authority over properties and owners with chronic deficiencies to promote preservation, rather than to terminate Section 8 and make preservation impossible. HUD should use its existing authority to require management improvements, changes in management companies, encourage transfers or deeds in lieu of foreclosure, and ensure that foreclosed properties are sold with project-based assistance intact to maximize the opportunity for preservation. Make foreclosure the last alternative rather than the first.

Recommendation 2.6: Assure quality of buyers of HUD troubled properties.

By general policy, implemented by field offices, HUD should comply with the intent of Section 219 of P.L. 108-199 and other preservation laws by ensuring that potential buyers of HUD troubled properties are qualified preservation buyers with track records of preserving affordable rental housing, a commitment to preservation for the benefit of low- and middle-income tenants, feasible business plans for the housing they are purchasing, and a record of substantial compliance with housing regulations and codes.

Recommendation 2.7: Allow contingencies for new construction.

HUD currently allows a contingency for substantial rehabilitation projects, but not new construction. Contractors increase their trade payment breakdown line items to cover unforeseens on new construction. Underwriting would be clearer if HUD allowed a new construction contingency of 5% of the construction contract amount.

Recommendation 2.8: Allow the option of balloon mortgages and lower floaters.

HUD now permits only long-term, fixed rate mortgages. Shorter term mortgages (for example, 18 years or the shortest term of the affordable use restrictions, at the option of the borrower) would bring the obtainable interest rate down the yield curve and facilitate new transactions. Lower floaters for tax-exempt bond projects are also very helpful right now for the same reason; the interest rate is lower down the yield curve.

Recommendation 2.9: Correct the annual contribution to reserves for replacement to \$250 per unit per year.

HUD uses .6% of structures (which can now reach more than \$1,000 per unit per year for new construction with structured parking) to calculate the annual contribution to reserves, which is included in operating expenses for underwriting. Substantial rehabilitation requires .4% of the mortgage (which is often a very low amount). The multi-family industry and most lenders recognize that it is really too expensive to reserve enough money annually through the operating budget to replace all building components when they reach the end of their useful lives. Most properties refinance in 15 years to obtain funds for repairs. The industry standard contribution is \$250 per unit per year. HUD should correct the required annual contribution to \$250 per unit per year for both new construction and substantial rehabilitation projects. Market rate properties spend more than this sum anyway to remain competitive in the market.

Recommendation 2.10: Keep to the Multifamily Accelerated Processing (MAP) time frames.

Some field offices keep to the 45 or 60 day review periods but many do not. Those that do not complain of being overwhelmed and understaffed. Nevertheless, HUD will become an increasingly important source of debt in the next 2-3 years and has an important role to play in helping the country out of the current recession. The program needs to be predictable, reliable, and timely. Even shorter underwriting reviews would be better.

Recommendation 2.11: Release cash flow monthly.

HUD has a long-standing policy of allowing owners to take cash flow once a year following the annual audit. This system is an old-fashioned and cumbersome attempt to keep properties from defaulting, but does not actually achieve

that goal. Properties default whenever they cannot continue to pay their debt service. Monthly release of cash flow makes HUD-insured mortgages more attractive to equity providers.

Recommendation 2.12: Allow more retail/commercial space in Section 221d properties.

HUD now allows retail/commercial space of 10% of gross square footage and 15% of gross income in Section 221d properties. For projects located in areas of concentrated revitalization, Section 220 allows 20% of gross square footage and 30% of gross income. If Section 221d allowed larger retail/commercial areas, important urban mixed-use properties could be developed, even if they are not located in areas of concentrated revitalization.

Recommendation 2.13: Define elderly as age 55.

The Fair Housing Act and the Housing for Older Persons Act (HOPA) both define “elderly” as age 55 or older. The National Housing Act defines “elderly” as age 62. HUD has two multi-family insurance programs for providing elderly housing. Section 221d allows elderly families (one person in the household is age 62 and everyone else can be of any age, including grandchildren). Section 231 allows 50-100% of the residents to be age 62, thus allowing elderly-only properties. Most zoning requirements follow the Fair Housing Act and HOPA. The National Housing Act should be conformed to Fair Housing and HOPA.

Recommendation 2.14: Correct Section 231 underwriting.

Section 231 works fine for new construction, but not for substantial rehabilitation. The Section 231 program for substantial rehabilitation should be corrected to allow “as is” value in the replacement cost mortgage. It now allows the lesser of “as is” value or outstanding indebtedness, thus discriminating against current owners who have paid down their debt. The 221d programs were corrected about 20 years ago to allow “as is” value in the replacement cost mortgage for all owners. The Section 231 program should follow suit.

Recommendation 2.15: Modernize ground leases.

HUD accepts ground leases as acceptable site control for insured mortgages. The underwriting should be modernized to recognize value for a borrower's leasehold interest. In a perfect ground lease, the landlord would be paid over time sums which, when presented valued, would exactly equal the “as is” value of the ground. Ground leases are seldom this perfect. While no borrower should pay more for a ground lease than the “as is” value of the ground, landlords are frequently willing to take less. Value thus accrues to the leasehold interest of the borrower. HUD should correct Section 7.16 of the MAP guide to recognize leasehold value in the replacement cost mortgage. HUD should also not require conversion to fee simple at a sum specified at construction loan closing in the event of default for for-profit landlords (a waiver of this conversion requirement is available for public landlords).

Recommendation 2.16: Correct Master Lease underwriting requirements.

Properties that qualify for a variety of tax credits are more economic if a master landlord takes the tax credits and is a separate entity from the Mortgagor. HUD issued guidance for master leases on March 3 and March 5 which opened HUD underwriting to allow for Master Leases. The guidance, however, contains a few onerous provisions including withholding the developer fee and surplus cash until the project has achieved sustaining occupancy for 2 consecutive years. We understand that HUD is working on and needs to complete industry-acceptable revisions.

Recommendation 2.17: Allow Firm Commitment applications with less than 100% plans, specs, and costs.

HUD will not accept an application for Firm Commitment for new construction or substantial rehabilitation without 100% plans, specs, bid costs, and a thorough review by a third party. This requirement adds months to the application process. If HUD would accept 75-80% plans, specs, and reasonable costs for the Firm Commitment application, a reasonable cost-limited mortgage could be determined. 100% plans, specs, costs, and a third party review would become a closing requirement. Mortgage calculations are reprocessed anyway when the final interest rate is known. This reprocessing could include both the debt service calculation and the final cost calculations.

Recommendation 2.18: Correct mortgage insurance premium (MIP) for Section 223f.

The current statutory requirement of 1% initial MIP for Section 223f properties is too high and the rate should be adjusted to closer to .5%.

Recommendation 2.19: Allow MAP underwriting for Section 241 loans.

Section 241 allows secondary loans for repairs to be insured by HUD as long as the first mortgage is also insured by HUD or if the proceeds are to be used for energy improvements. This loan program should follow MAP underwriting requirements and be added to the MAP Guide.

Recommendation 2.20: Allow meal service in Section 231 properties.

A new trend in housing the independent elderly includes simple meal service with a rental apartment. HUD does not currently permit meal service. HUD should allow mandatory meal service without requiring State licensing as an assisted living facility.

Recommendation 2.21: Allow construction on sites deemed residentially safe by the States.

HUD has many environmental restrictions that prevent construction in older urban areas. These restrictions prohibit construction on sites that have active monitoring wells, nearby cell phone or TV towers, or propose to cap contaminated soil. These environmental conditions should be allowed if the State or local regulatory agency, delegated the responsibility by EPA, deems the site safe for residential construction.

Recommendation 2.22: Allow non-profits to benefit from payment in lieu of taxes (PILOTS).

HUD requires that tax abatements run with the land, not the non-profit legal status of the sponsor, in order to take tax abatements into account in underwriting. The two exceptions are tax credit projects which receive tax abatements by virtue of a non-profit general partner or Section 202 refinances that already have tax abatements by virtue of a non-profit ownership. All tax abatements given to non-profits should be recognized in the underwriting. HUD prohibits non-profit tax abatements from being recognized because, in the event of default, HUD wants a project that could be sold to either non-profit or for-profit borrowers with the same economics (i.e. underwritten with full real estate taxes). There are enough non-profit borrowers in the market to find borrowers for these properties. Non-profit buyers are also more likely to keep the properties affordable.

Legislative Recommendations

Recommendation 3.1: Set aside mortgage insurance premiums as a Housing Trust Fund.

The Trust Fund would be administered by HUD and allocated through the field offices rather than using them to keep the mortgage insurance fund solvent, which should not be refunded to Congress.

Recommendation 3.3: Increase per unit statutory limits by a construction inflation factor.

Construction costs have increased dramatically in the last five years, particularly in urban infill areas, so that many otherwise financially feasible rental mortgages are artificially increased to the maximum per unit dollar amount allowed by the statute and made financially infeasible. Statutory limits mortgages are first derived from dollar limits published by Congress, inflated by the consumer price index annually, multiplied by a high cost factor, and complicated by complex addition of “costs not attributable to the dwelling unit,” which cause many additional calculations and still do not support projects in urban or high-cost areas. Statutory limits were designed to keep HUD's lending in the affordable housing arena, but many important high-end, mixed-use, mixed-income urban development projects in emerging areas are prevented by low statutory limits mortgages. The dollar limits published by Congress should inflate by a construction cost inflation factor, not the consumer price index.

ADDENDUM 2.2

MID-TERM STRATEGY – Preservation Recommendations

Preservation Topic 3: Administrative Actions to Encourage Preservation of Affordable Housing

Administrative Recommendations

Recommendation 12.1: Model leadership on preservation.

Provide guidance from Washington through top-down, explicit leadership on preservation, so that all U.S. Department of Housing and Urban Development (HUD) offices understand that they have a mandate from the Secretary to preserve affordable housing, know the available tools, are encouraged to use them, and have discretion to adapt them to the needs of specific properties and preservation transactions.

Recommendation 12.2: Solicit input on policy changes and opportunities to improve preservation practices.

Reach out to residents, managers, owners, and developers of affordable rental housing to develop best practices.

Recommendation 12.3: Approve rent increases for owners of Section 221(d), Section 236, and Section 202 elderly properties.

Approve 100% Section 8 rents when authorized and justified by the market, to encourage recapitalization and to provide for needed property improvements and continued owner participation.

Recommendation 12.4: Revise regulations 24 C.F.R. §§ 236.10, 880.205(a), 881.205(a), 883.306(a), and HUD handbook 4560.1 § 3–6(E) to allow project income distributions to non-profit owners on the same basis as limited distribution for-profit owners.

By general policy, allow non-profit owners to receive distribution of proceeds from sale or financing of assisted multi-family housing projects.

Recommendation 12.5: Use existing discretion to provide rent increases, when authorized and justified by the market, to encourage recapitalization, continued owner participation, and the transfer of at-risk properties to non-profits.

One simple and effective example: rescind the recently promulgated counter-productive changes to Chapter 15 of the Section 8 Handbook (which discouraged the use of tax credits on HUD assisted properties and raised uncertainties about HUD's available resources) and expand on the original concept of promoting non-profit preservation-based transfers by a) reducing uncertainty about potential HUD resources and b) allowing access to market rents on both to-be-improved properties and Housing Finance Agency financed properties.

Recommendation 12.6: Honor the non-profit incentives in the Mark to Market program and end the practice of requiring repayment of mortgage restructuring notes as a percentage of the developer fee earned by a non-profit purchaser.

HUD should also extend its self-imposed limit on the period to assign or forgive second and third mortgages for properties restructured under Mark to Market from the current three years to five years in order to facilitate the long-term preservation of more of these properties.

Recommendation 12.7: By general policy, provide tenant protection vouchers on a one-for-one replacement basis for all lost or converted affordable units, not just occupied units (rescinding limitations such as those contained in PIH 2006-5).

Recommendation 12.8: By general policy, make 20-year Housing Assistance Payment (HAP) contracts, subject to appropriations, available in preservation sales and refinancings, regardless of when the current contract will expire.

Recommendation 12.9: By general policy, provide the tools to preserve state-Housing Finance Agency (HFA) financed projects.

- Clarify that HUD will continue to provide project-based Section 8 upon prepayment of such a property.
- Rescind the generally discredited 2002 HUD Office of General Council (OGC) opinion stating that Section 8 contracts on state-HFA financed properties terminate upon HFA mortgage prepayments.
- Allow owners of state-HFA financed properties the right to mark up to market prior to contract expiration in exchange for an extended Section 8 commitment subject to appropriations.

Recommendation 12.10: By general policy, permit the assumption and subordination of Section 202 loans, Flexible Subsidy loans, and other loans where warranted by the needs of the property or residents in order to facilitate preservation and rehabilitation and reverse the discredited OGC opinion limiting assumption of Section 202 loans by a non-profit controlled limited partnership.

Recommendation 12.11: Revise the Section 202 Use Agreement required in preservation sales or refinancing, which now bars the owner from charging rents above 30% of income even when Section 8 is not renewed or funds are not appropriated.

Recommendation 12.12: By general policy, but subject to case by case review in field offices, allow affiliated owners in the same state to merge or cross-collateralize loans in preservation sales or refinancings of small properties and Section 202 properties.

Recommendation 12.13: By general policy, but subject to a case by case determination, empower field offices to determine that there are chronic vacancies in the efficiencies in a particular property and allow the units to be combined and reduced and any excess Section 8 project-based assistance to be transferred.

Recommendation 12.14: Remove the 7.5% ceiling on secondary seller financing in a preservation sale or refinancing using Section 223(f) insurance.

Recommendation 12.15: Revive cities' right of first refusal for disposition sales by interpreting the Deficit Reduction Act of 2005 to allow consideration of repair or rehabilitation costs in determining market values for HUD-owned buildings and HUD-held loans.

Recommendation 12.16: By general policy, but subject to case-by-case review in field offices, allow the use of residual receipts for rehabilitation projects in cases where residual receipts are held.

Recommendation 12.17: By general policy, but subject to case by case review in field offices, allow owners to transfer residual receipts and replacement reserves from one property to another property owned by an affiliate where necessary to meet the physical or financial needs of the second property.

Recommendation 12.18: By general policy, implemented by the field offices, exercise its affirmative obligation under Section 250(a) to make sure that prepayments are not allowed where the prepayment will result in the loss of necessary affordable housing.

Recommendation 12.19: Use the authority conferred by Section 215 of the FY 2008 HUD Appropriations Act and section 8bb to allow owners to transfer Section 8 authority to other properties when a property is obsolete.

Recommendation 12.20: By general policy, but subject to case by case review in field offices, in the context of a preservation transaction continue paying Interest Reduction Payments in their entirety, notwithstanding a reduction in total units if such a reduction is warranted by changing market conditions, physical obsolescence, and other factors.

Recommendation 12.21: By general policy, direct field offices to encourage and support preservation purchasers willing to take over distressed properties by allowing them time to seek capital for rehabilitation

rather than attempt to force immediate repairs and by appropriate accommodation in the Real Estate Assessment Center (REAC) and Transfer of Physical Assets (TPA) processes.

Recommendation 12.22: Ensure that rent increase requests are processed at or near the time of recapitalization, whether or not related to recapitalization, in the manner provided under HUD’s current handbooks and procedures.

Recommendation 12.23: Regularly provide updated information on its public website about recent REAC scores, opt-out notices, and mortgage prepayment requests, and link this information to the existing database on HUD-assisted rental properties. Protect enhanced voucher holders by clarifying that owners must accept enhanced vouchers and evict only for good cause, and by clearly prohibiting Public Housing Authority (PHA) re-screening of income-eligible tenants.

Please note that this recommendation has essentially been accomplished by HUD at present. The working group recommends that the Department maintain diligent updating.

Legislative Recommendations

Recommendation 13.1: Seek legislation to create a special type of project-based assistance intended specifically to promote the acquisition/rehab or refinancing by qualified preservation owners of properties with maturing mortgages and no or partial rental assistance.

This action will protect tenants from rent increases and support a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation or refinancing with renewed affordability of properties with maturing mortgages and no or partial rental assistance.

Recommendation 13.2: Seek legislation to permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

This action would enhance a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation with renewed affordability of properties that would otherwise leave the affordable inventory.

Recommendation 13.3: Seek legislation to permit an owner to convert such assistance, which is not renewable, to Section 8 assistance, which is renewable.

This action would facilitate a qualified preservation owner’s ability to acquire/rehab or refinance a property with Rent Supplement/Rental Assistance Payment (RAP) assistance.

Recommendation 13.4: Permit the Secretary, at an owner’s request, to authorize project-based assistance when an “eligibility event” would otherwise make the tenants eligible for enhanced voucher assistance.

This action would enhance a qualified preservation owner’s ability to leverage non-HUD resources to support the acquisition/rehabilitation with renewed affordability of properties that would otherwise leave the affordable inventory.

Recommendation 13.5: Seek legislation to make 20-year, Sec. 8 contracts (subject to annual appropriations) available upon request to qualified preservation owners who wish to acquire/rehab or refinance these properties.

This action would facilitate the recapitalization or acquisition/rehabilitation by qualified preservation owners of properties with long-term (typically 40-year), fully funded Sec. 8 contracts that are set to expire within the coming years. Absent the ability to cancel the current HAP contracts, which have but a few years remaining, qualified preservation owners will be unable to maximize the leveraging potential of Low Income Housing Tax Credit (LIHTC)/bond resources. The current debt holder (mostly states but also some local agencies) would need to agree to cancel the current HAP contract.

CHAPTER 3

THE “HARD TO HOUSE”: CREATING HOUSING OPPORTUNITIES FOR THOSE IN GREATEST NEED

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

OVERVIEW

Certain individuals and families are generally not served by the mainstream housing market: those with poor rental histories, homeless persons, those with chronic physical or mental disabilities, chronic substance abusers, the formerly incarcerated, the frail elderly, disabled veterans, persons living with AIDS, and transitioning youth. They are perceived as risky or undesirable prospective tenants. In some cases, they are specifically and officially excluded from the U.S. Department of Housing and Urban Development (HUD) assisted housing.³¹ Their marginal housing circumstances contribute to these households remaining on the margins of American life more generally. Not only do their social and housing circumstances limit opportunities for social and economic mobility, but their tenuous housing situation often causes these families and individuals to be more costly to communities and government budgets. Without stable housing, they rely on shelters; they frequent emergency rooms; they are placed in nursing homes unnecessarily or end up back in jail at considerable public expense. **Multiple studies demonstrate that it is far more costly to allow these households to remain homeless or marginally housed than to provide them with access to a stable home.** In fact, the continuing failure to meet the housing and service needs of these populations places a tremendous strain on state spending for Medicaid and corrections, two items which fast consume growing shares of most state budgets.³²

What each of these typically excluded groups has in common is the need for some degree of supportive services to assist them in being successful tenants and neighbors and active citizens. Supportive services linked to housing have been shown to decrease the involvement of the Hard to House with costly institutions and to increase their opportunities for employment, treatment, and recovery. Without an intentional effort to house these households, states will continue to spend heavily on crisis-focused services to respond to the relatively small group of households who use health care and emergency services in an unnecessary and disproportionately costly way.³³

The Economic Recovery bill and, perhaps, the 2010 budget present the opportunity to make significant structural corrections to alleviate long-standing challenges and inefficiencies in many areas. We urge HUD to seize this occasion to make housing the Hard to House an agency priority and deliver permanent budget relief to state and county governments heavily burdened by the costs of caring for the Hard to House when they cannot access mainstream housing.

The models for these arrangements exist and involve collaboration between government housing and human services agencies. HUD's leadership and the strong support of the White House can bring these models to scale.

HUD and the nation have made great progress in recent years blending income groups in mixed developments. HUD's leadership is now needed to encourage social integration, and the inclusion of Hard to House households into mainstream buildings and neighborhoods.

³¹ The formerly incarcerated with certain felony convictions.

³² Corporation for Supportive Housing

³³ Ibid.

This document offers a vision and specific guidance to the incoming Obama administration for HUD's role in meeting the housing needs of special populations who are not served by mainstream housing markets. Our group recommends the following items, described within the report, for immediate action:

1. With White House support, engage Health and Human Services (HHS), Veterans Affairs (VA) and other federal agencies to create interagency mechanisms for coordinating service dollars and housing investments targeted to the Hard to House. Initiatives would range from joint housing production programs (a good model for which would be the New York-New York III Agreement), enabling more flexible use of Medicaid, and expanding existing interagency initiatives such as VASH.
2. Empower HUD Regional Offices to play local coordinating roles in implementation of interagency Hard to House Strategy.
3. Link set-asides for Hard to House to real estate industry requests for HUD assistance. Coordinate this with a supply of incremental vouchers and appropriate service funding commitments.
4. Use HUD programs in tandem with the Economic Recovery Act and the upcoming stimulus legislation to advance stalled housing projects, requiring set-asides for the Hard to House wherever feasible and to the extent that service dollars and rental subsidies can be provided.
5. Finish the job of ending chronic homelessness by using HUD-provided Section 8 vouchers matched by service dollars from other government agencies to create 90,000 new supportive housing arrangements. Empower local housing authorities to use these funds flexibly in partnering with the landlord community, local providers, and local public and behavioral healthcare systems.
6. Finish the job of re-housing those made homeless by Katrina: HUD should provide a special allocation of up to 12,000 Section 8 vouchers for New Orleans.
7. Fully fund the implementation of ten high-quality Ten Year Plans. Treat these communities as laboratories for testing new strategies and bringing proven approaches to scale. Enable each community to draw up to \$20 million in new resources to fully implement their plans.

DEFINITION

“Hard to House” groups are those with very low incomes (below 30% of the area median income [AMI]) who *also* face unusual barriers to housing. Their access to stable, suitable housing is blocked by one or more of three factors:

- stigma
- physical needs that drive specific housing requirements
- service needs that drive specific housing requirements

We have focused specifically on those households which require more than economic assistance to access and succeed in housing. Therefore, we did not include very low income families or well seniors in our definition, and trust that their needs will be represented in policy recommendations on the future of public, senior, and multi-family housing. We also recognize that because of the current economic crisis, there may be a new group of people emerging who are in need of support linked to their housing – those about to lose their homes, whose credit has been compromised, and displaced workers. We will not be addressing these households directly in this document, however, other than by making the case for linking support to housing to assist vulnerable households.

The housing-related assistance required by each Hard to House group varies in ways that reflect the obstacles they face in securing suitable housing.

The stigma faced by the formerly incarcerated, the mentally ill, homeless persons, persons with AIDS, and those with substance abuse issues makes landlords wary of renting to them and makes it difficult to site projects specifically dedicated to these groups.

The frail elderly, the cognitively impaired, and those with physical disabilities require housing that is physically adapted for their needs. Some frail elders, brain-injured, and disabled individuals can manage well in conventionally designed housing if necessary support services are in place. Others are needlessly institutionalized for want of suitable housing.

Many of those with chronic health and mental health challenges, or who have experienced severe trauma, such as disabled veterans, disconnected youth, and those made homeless by Hurricane Katrina who remain in shelters, on the street or in abandoned properties, need consistent access to services, ranging from case management to assistance with daily living skills to employment assistance. It is this layer of support that enables them to succeed as tenants and make their housing a springboard to a stable life.

The proportion of households who fit within these definitions has not been calculated. Some indications, however, can be garnered from the over 127,000 chronically homeless identified in HUD's 2007 Annual Homeless Assessment Report; the 600,000 individuals released each year from US prisons,³⁴ many without homes to return to; the 4.2 million poor, mentally ill individuals, 15,000-20,000 of whom remain in long term psychiatric institutions;³⁵ the 12,000 estimated homeless in New Orleans; the 5.3 million poor individuals with physical disabilities; and the five percent of homeless families with multiple impairments³⁶ who need support in addition to an affordable rent. These figures need, moreover, to be expanded to include those members of other populations—the young who leave foster care, the frail elderly, and veterans—potentially needing both affordable housing and support services if they are to live independently in the community.

This information can and should be gathered, from housing authorities, county and state human services agencies, corrections departments and other primary sources of information on the housing status of these special populations, and made part of HUD's – and the local communities' – ongoing planning.

Recommendation 1: Determine appropriate means to measure Hard to House need and track and report on an annual basis.

Not all vulnerable people require assistance with housing. Some are helped by families or community organizations. Yet the magnitude of the Hard to House population should be understood in at least two ways. First, the needs of the Hard to House represent a significant housing challenge to the nation. Second, the choice is not whether to spend the money to house these Hard to House individuals and families, but whether the Hard to House – and society – will have anything to show for the money we spend. Multiple studies have verified that the cost of allowing the Hard to House to drift in and out of institutions and homelessness far exceeds the cost of providing suitable housing linked to support services.³⁷

VISION

No one should be left out of housing. HUD, as the main advocate of our national values around housing, must champion this, and claim the Hard to House as a principal responsibility of the agency. It is in keeping with the aspiration of the Housing Act of 1949, where Congress first articulated a national housing policy goal of a “decent home and suitable living environment for every American,” that HUD assert its commitment to the Hard to House throughout its agency culture and programs.

What are the obstacles to achieving this goal in 2009? Where, with HUD leadership and White House support, are the critical opportunities for progress? This analysis and the accompanying recommendations for HUD action reflect the collective insights of private developers of mixed-income housing; government housing officials; private lenders; not-for-profit developers; property managers; and housing and homeless policy experts. Our recommendations fall into three areas:

1. Integrating Housing and Services
2. Incorporating the Hard to House within HUD programs and housing markets
3. Supporting local ten year plans to end homelessness

³⁴ Council of State Governments

³⁵ New York State Office of Mental Health

³⁶ National Alliance to End Homelessness

³⁷ Notably Dennis Culhane, 2002

In each area we suggest ways in which HUD can advance housing opportunities for the Hard to House through direct investment, coordination, regulation, and by setting the tone and expectations for success.

INTEGRATING HOUSING AND SERVICES

A. The Challenge

Two things make landlords open to accepting the Hard to House as tenants: a guaranteed rent and consistent and responsive support services. HUD has mechanisms for guaranteeing rents, and we will go more deeply into ways that HUD can be more effective in targeting Section 8 resources to benefit the Hard to House. Yet there is no structural mechanism for linking housing and support service resources for the Hard to House among federal agencies, and this deficit is in effect at virtually every level of government.

We do not advocate that HUD expand its direct services funding:³⁸ that does not fix the fundamental problem and diverts HUD dollars from creating critically needed housing. Rather, HUD is needed to act as integrator of federal resources across agencies on behalf of the Hard to House.

This is first and foremost a leadership issue. For HUD, the Hard to House are a classic “wrong pockets” problem: HUD must make significant investments in solving the problem but will not benefit from the long-term cost savings in other areas of government spending. Nevertheless, we have faith that HUD, with the support of the White House, can institute the collaborations with HHS, with the VA and with other federal agencies charged with spending taxpayer dollars on the Hard to House.

For HUD to be successful in leading a national effort to house the Hard to House, we recommend that the White House convene an inter-agency workgroup with the assignment to increase housing and service options for Hard to House households. HUD’s leadership will be essential in demonstrating to other federal agencies the opportunities for linking service funds to housing supports for the Hard to House. This work group can also identify the statutory barriers that must be addressed within each agency or by Congress to enable effective coordination of housing and service dollars.

B. Recommended Directions

1. Investment

Recommendation 2: With White House support, HUD must play a leadership role in a federal inter-agency initiative to create a national system to house the Hard to House. Similar to the New York-New York III Agreement (outlined below), this system would match service and housing dollars for the Hard to House, allowing for local flexibility and innovation. HUD should increase the allocation of Section 8 and other agency resources to advance this interagency effort. Regional offices should be empowered to play a coordinating role with other federal agencies and with state and local governments in linking housing and service funds to specific projects.

A model for what is needed nationally is the New York-New York III Agreement. New York-New York III, the plan crafted by Governor George Pataki and Mayor Michael Bloomberg, is facilitating the creation of 9,000 units of supportive housing in New York City. The Agreement pools the resources of twelve different city and state agencies and matches them to the City’s chronic homeless and other prioritized Hard to House groups including the institutionalized mentally ill, homeless families with complex needs, transitioning youth, and the medically frail. The Agreement links the capital funds and tax credit allocations of State and City agencies with services funds provided by health, mental health, human services, and substance-abuse agencies. The billion dollar capital investment, and \$153 million in annual services dollars, is expected largely to pay for itself over time, with substantial reductions in hospitalization, shelter, jail, and treatment costs associated with the 9,000 households.

³⁸ With the exception of expanding support for Residents’ Service Coordinators, addressed in Recommendation 7.

A similar, cross-agency approach is needed nationally to enable the Hard to House to access and succeed in housing. Secretary Donovan should encourage the White House to convene and engage federal services agencies along with HUD to create a process for matching service dollars to HUD's housing investments for Hard to House households.

The most significant opportunity for HUD collaboration is with HHS. Runaway Medicaid costs are breaking the back of county and state governments; high episodic treatment costs of Hard to House individuals contribute to this. Studies show that a disproportionate percentage of that spending is associated with a small percentage of users with multiple challenges, who tend also to belong to the population of Hard to House citizens. Reducing the burden placed on health systems by the Hard to House would entail significant reductions in Medicaid expenditures for emergency room, inpatient, psychiatric and alcohol/drug treatment. One promising strategy that has been used effectively with the frail elderly and developmentally disabled is to create enrollment-capped Home and Community Based Services waivers to allow Medicaid funds to be used to serve Hard to House individuals in their homes or in supportive housing, including case management services based on a single plan of care.

Persuading Medicaid to more flexibly cover mobile, individual plan-based treatment, case management, and other services will not be an easy task. HHS has for years resisted the linkage of Medicaid to housing and there are long-standing biases against the use of Home and Community Based Services for adults with mental illness. Yet the clinical and fiscal benefits to Medicaid itself are now well established. Part of this changed context is a much smaller population of institutionalized mentally ill. Earlier HHS concerns, that Medicaid dollars would replace state investments and make the care of the institutionalized mentally ill financially unsustainable, were expressed against a background of tens of thousands of people in long term psychiatric hospitals; now, it is estimated that fewer than 20,000 long-term patients remain in psychiatric institutions nationwide.³⁹ Not only are these current populations smaller than in previous decades, but the data showing the savings and enhance care that can be achieved through supporting special needs households is now available.

Data on the comparative costs of nursing home care for the elderly versus home care is relevant to this discussion, as is data showing the costs of homelessness versus supportive housing. The stark difference in cost, for example, between Medicaid-funded institutional care and Medicaid-funded, home-based care demonstrates how much is at stake in creating more flexible Medicaid-funded housing supports. A 2004 study showed the average annual per-person costs for nursing home services were \$25,585, and only \$8,440 for those supported in their own homes.⁴⁰ Culhane's study showing that homelessness is more costly than supportive housing extends this argument to the hard-to-house.⁴¹ The extreme costs for this group cut across many services (law enforcement, emergency rooms, different kinds of inpatient care, detox) and are thus "invisible." The supportive housing community knows with certainty that coordinated services for the hard-to-house are a necessity. HUD's leadership to bring this point to HHS and the Centers for Medicare and Medicaid Services (CMS) is essential.

There are thoughtful, disciplined ways to create greater flexibility in the use of Medicaid that would reap significant savings for federal and state governments. For instance, limiting Medicaid funded housing services to SSI recipients and certain narrowly defined other groups (homeless or chronically ill individuals who are high-cost patients, for example) would be a way to move the issue forward.

HUD's partnership with the Department of Veterans Affairs through the Veterans Affairs Supportive Housing (VASH) program is in some respects a model that HUD might follow with other government agencies. In the VASH program, HUD provides Section 8 vouchers. The VA manages the distribution of the vouchers at the community level in partnership with local housing authorities and couples the vouchers with support services provided by VA staff. In building on this model, we would urge a more flexible design than the current VASH program. A revised program should allow project basing on Section 8 and for community-based service providers to provide support services on a contracted basis, rather than require that only VA employees perform the work. With these caveats, we can imagine the VASH model being applied successfully, for example, to transitioning youth or the chronically homeless, with HHS providing services funds matched to HUD Section 8 vouchers and private landlords providing many of the housing units.

³⁹ New York State Office of Mental Health

⁴⁰ Senior Supportive Housing report of Stewards of Affordable Housing for the Future and American Association of Homes and Services for the Aging

⁴¹ Culhane 2002.

The actual work of matching individuals, housing and services occurs in communities. *The regional HUD offices should be empowered to oversee the actual local implementation of a coordinated Hard to House strategy with HUD in a leading role.*

2. Regulation

Recommendation 3: Make HUD a center of housing innovation. Allow regulatory flexibility to encourage new housing arrangements suitable for the Hard to House. Establish a “Hard to House” Coordinator position within the agency.

Part of what makes the Hard to House difficult to house is that we do not yet know all the types of arrangements that will be most successful for them, given the range of populations and needs. Unconventional arrangements, adapted to individual circumstances, may be needed. To encourage innovative solutions to the housing needs of the Hard to House and other households where new approaches to design may be desirable,⁴² we urge HUD to create a flexible regulatory framework while assuring baseline quality. Rules governing room sizes, leasing arrangements, marketing practices, and opportunities for blended financing must be re-examined, with a view toward removing barriers to allow creative problem solving. Making the housing needs of the Hard to House a centerpiece of the agency’s agenda invites HUD to become a center of housing innovation. From shared housing arrangements to new designs suitable to the frail elderly or cognitively impaired, and from new leasing arrangements, such as allowing Section 8 to be used by service providers to rent apartments on behalf of Hard to House clients, to new marketing practices more effective than randomized lotteries in reaching a targeted population, innovative ideas should be encouraged and tested.

Further, the potential role of technology in housing generally, and in addressing the housing needs of the Hard to House in particular, is largely unexplored. Innovation in service provision in rural areas can be enhanced through creative uses of technology. “Smart” building features may have implications for making properties more secure or alerting service providers to clients in distress. New technologies, or new uses of existing technologies, could make existing housing allocation and income and need verification processes obsolete, as well as better link residents with information on services and jobs.

HUD must have a regulatory culture that supports exploration with innovative tools and approaches and provides incentives to create new architectural and technology-based responses to the needs of the Hard to House. Yet there must also be effective quality control to block abuse of any flexibility created. *We recommend the creation of a Hard to House coordinator position within HUD who could bridge all existing HUD special-needs programs, facilitate the agency’s collaboration with other federal agencies, be the point of contact for approving innovative policies or design, and act as the internal advocate at HUD representing the needs of the Hard to House in each HUD program.*

Recommendation 4: Use HUD’s leverage to challenge exclusionary local housing practices. Link HUD grant priorities and other assistance to communities’ openness to supporting housing for the Hard to House.

Local regulations and local interpretations of federal housing regulations create significant barriers to housing the Hard to House. Familiar examples are local zoning provisions that restrict occupancy by multiple non-related adults, thus frustrating shared housing arrangements, or requirements for costly special permits or extensive public review processes when housing will include supportive or rehabilitative services, or the rigid interpretations communities impose on Section 8 eligibility guidelines in order to exclude many formerly incarcerated individuals from government assisted affordable housing, even in cases where circumstances would argue for leniency. We urge HUD to address these barriers and to use its funding leverage (e.g., in cases where funding is allocated on a competitive basis, HUD should give credit to communities with active efforts to create housing for the Hard to House) to move communities to adopt more inclusive housing practices.

C. Setting the Tone and Expectations

Our recommendations reflect the reality that HUD cannot meet the housing needs of the Hard to House alone. The agenda requires collaboration across federal government agencies that are unaccustomed to joint initiatives, and between federal, state and local housing, social service, and land use agencies where HUD’s influence will often be

⁴² See, for example, recommendation of Multi-Family Task Force for “charter housing” for non traditional families, or for live-work space

indirect. We recognize that this is not something that HUD can make happen on its own. It will require leadership by the White House along with a commitment by the Administration to make housing the Hard to House a priority. This is most clearly accomplished by considering the Hard to House in the design of every HUD program. The recommended position of Hard to House coordinator at HUD would be a resource to the agency in sustaining this focus.

INCORPORATING THE HARD TO HOUSE WITHIN HUD PROGRAMS & HOUSING MARKETS

A. The Challenge

Housing the Hard to House is a large and urgent task; solutions must draw on the full range of the nation's housing resources. In addition to the nonprofit developers who are producing most of this housing now, mainstream developers, private landlords, housing authorities, and new forms of private-public partnerships must be encouraged to take up the task.

Although there is a perception that integrating housing for the Hard to House into established segments of the private market—including mixed-income multifamily housing and scattered-site single-family segments—hinders marketing, leasing and operations of such housing, recent research suggests no such impact. Several state-sponsored “80/20” initiatives in Massachusetts, Louisiana, Minnesota, and other states, and a number of HOPE VI mixed-income projects around the country have successfully integrated Hard to House components into their developments without any adverse leasing or operating effects. Moreover, when queried, many developers indicate a willingness to include housing for the Hard to House in their projects if needed subsidies and “on-call” services linked to their housing can be bundled for them.

States have drawn on the lessons learned in successful supportive housing, and corrected the problems that resulted, for instance, when non-elderly disabled households were blended with seniors in public housing and HUD-funded 202 programs without putting support services in place. Our group recognizes that the success of mixed-income projects that include the Hard to House can be highly dependent on the presence of supportive services, just as all mixed-income housing has been found to be sensitive to location and service issues.

The evidence that the Hard to House can be successfully included in “80/20” and other mixed-income projects comes from efforts such as that in Massachusetts, where the Massachusetts Housing Finance Agency has required that 3 percent of the units in all projects they finance be set aside for a subset of the Hard to House, specifically clients of the state Departments of Mental Health and Mental Retardation. Louisiana requires a 5 percent set-aside. Minnesota negotiates some number of Hard to House units into each project. Each of these state housing agencies has also succeeded in obtaining the commitment of matching service dollars from sister state agencies or, in the case of Louisiana, from HUD as part of its Katrina recovery package. Each state attaches rental subsidies to the Hard to House units as well.

Successfully producing housing for the Hard to House depends on several factors, including: establishing flexible policy objectives for including a market-defined mix of housing for the Hard to House in various types of developments; undertaking careful planning and thoughtful project design; building community support for the desired housing mix; accessing a bundle of favorable financing and/or capital and operating subsidies; and providing attentive property management along with well-aligned, highly-responsive supportive services.

The record to date suggests that the marketplace will favorably respond to leadership from HUD in promoting additional housing for the Hard to House if it fosters a comprehensive approach as outlined above. The market will be unresponsive to “one-size-fits-all” policy directives or unfunded mandates for producing additional housing for the Hard to House.

As described in previous sections, HUD can foster linkages to needed supportive services across other federal agencies, particularly the Department of Health and Human Services, and with allied state agencies. It can also encourage states and localities to align funding and services, waive design restrictions, facilitate favorable zoning and

build support for varied forms and mixes of housing that include the Hard to House in return for its financing and subsidies.

But HUD can most effectively encourage a substantial increase in housing for the Hard to House in mainstream developments by bundling access to its many existing financing, subsidy and regulatory tools in support of this goal. As service funds are committed to Hard to House units, HUD can simultaneously offer needed financing *and* operating subsidies *and* regulatory relief in a streamlined process within the department.

The biggest single opportunity for short term impact on housing the Hard to House is to work with existing housing and more private landlords.

B. Recommended Directions

1. HUD Financing, Operating & Grant Programs

Recommendation 5: Provide incremental, flexible Section 8 voucher authority to enable expanded access to privately owned housing. As an immediate budget item, target significant, incremental Section 8 resources coupled with appropriate support services, to the Hard to House, beginning with those families and individuals who are now homeless. Allow flexible terms to maximize participation by a wide range of landlords and service providers.

HUD administers several housing operating subsidy programs through various public housing and Section 8 initiatives, ranging from the allocation of annual contributions contracts in mixed-finance developments to multiple forms of Section 8 “tenant-based” vouchers and “project-based” assistance and vouchers, including the ability to convert portions of tenant-based vouchers to project-based assistance. With incremental increases in Section 8 voucher authority, HUD could allocate additional vouchers with “exception” Section 8 rents in high-cost markets, enabling the Hard to House expanded access to privately-owned housing. HUD already allows considerable flexibility in applying operating subsidies to local needs for critical national priorities, such as rebuilding housing destroyed in the Gulf region or promoting economic stimulus, and under demonstrations, such as the public housing Moving-to-Work initiative. This flexibility could be extended to housing for the Hard to House as warranted. The flexibility provided under the Moving to Work program has enabled housing authorities in places (some are counties) such as Cambridge, Portland, Oakland, and King County to develop effective new approaches to using existing resources in partnership with public and behavioral health care systems. Expansion of this flexibility to additional housing authorities should be supported.

There are several promising examples of how these operating subsidies can be bundled with service dollars to create significant additional opportunities for housing the Hard to House. In King County, Washington, for instance, the housing authority paired Section 8 Moving-to-Work vouchers with service commitments from the state mental health agency to create a large network of supportive apartments in privately-owned housing. The Moving-to-Work provisions enabled the Housing Authority to contract directly with nonprofit organizations, which rented the units on behalf of Hard-to-House clients. This proved to be an arrangement many landlords found reassuring. Service system funds from five agencies were pooled to create an oversight structure for the support services to assure their responsiveness. In another example, New York City and State jump-started the New York-New York III program by providing operating subsidies and service dollars to allow community agencies to rent private “scattered site” apartments for the chronically homeless while the program’s new development pipeline was established.

Initiatives that engage the private landlord community represent the country’s most significant and immediate opportunity for rapid progress in providing housing for the Hard to House and should be a principal concern of HUD policy. Local 10 Year Plan initiatives in some communities have been successful in involving private landlords in housing the Hard to House. These efforts should be encouraged throughout the country.

We have urged HUD to lead an interagency effort informed by the New York-New York III Agreement to secure commitments of service dollars to be matched to housing investments in the Hard to House. This effort should make accessing existing privately-owned housing a central priority, particularly to reduce homelessness among the Hard to House. These new Section 8 resources, coupled with service funding, could also enable communities to acquire

foreclosed properties for reuse by Hard to House households and others in need of affordable housing. Creating supervised occupancy arrangements would also be a contribution to communities struggling to contain the effects of abandoned properties.

Recommendation 6: As an immediate budget item, provide additional Section 8 resources to complete the job of re-housing those made homeless by Katrina in New Orleans and surrounding communities. Additional Section 8 authority can be used to secure private housing with vouchers and project based to support additional redevelopment.

Louisiana incorporated a 5% Hard to House set-aside in the Gulf Opportunity Zone credits allocated to stimulate the rebuilding of New Orleans and surrounding communities. The softened credit market has slowed the pace of new development, however, leaving many residents, including those with special needs, in prolonged homelessness, living in public spaces or abandoned homes.

Recommendation 7: Establish the statutory flexibility to allow and encourage the production of housing for the Hard to House in FHA multifamily programs. Devise and include such objectives in tandem, to the extent that needed operating subsidies and supportive services can be bundled with the relevant insurance or capital advances.

Through FHA, HUD operates several insurance and direct financing programs—though some have been dormant—for the construction, rehabilitation, and refinancing of affordable multifamily housing that could be used to produce additional housing for the Hard to House [e.g., sections 207, 213, 220, 221(d)(3) and (4), and 231 insurance, and sections 202 and 811 capital advances]. Opportunities to include new policy objectives for the development of housing for the Hard to House in these programs may present themselves as the new HUD team looks to revive or modify some of these programs, subject to applicable statutory parameters. In structuring credit support and bond programs, inclusion of the Hard to House should be part of the package.

Models for these suggestions can be found in states that have made the inclusion of Hard to House units a priority of their housing finance. These states have also developed practices to reassure developers. In Minnesota, for example, the state Housing Finance Agency required a Hard to House set-aside within its mixed-income programs, compensating developers with rent subsidies and linking service dollars to the Hard to House units through a coordinated arrangement with the state mental health agency. They also created an innovative protocol to relax use restrictions if rental subsidies and/or companion service commitments cannot be sustained.

The Hard to House should be integrated within HUD's mainstream financing and insurance programs as a matter of course, however, we do not recommend that HUD promote new "stand alone" policy objectives related to the Hard to House in its insurance and capital advance programs without also aligning needed operating subsidies and supportive services essential to the successful development and management of such housing.

Recommendation 8: Within HUD's Multifamily Housing Service Coordinators grant program, broaden the class of eligible recipients to include the Hard to House as well as the elderly and disabled. Allow all developments offering housing for the Hard to House to apply residual receipts, excess income and/or budget-based or special rent adjustments to support on-site resident service coordinators as a standard practice.

An essential component of successful multi-family housing including the Hard to House is funding for site-based resident services coordination. This function facilitates the delivery of those services that enable Hard to House households to be successful tenants. Sometimes also referred to as "concierge services," such on-site coordination ensures that needed supportive services are responsive, continuous and appropriately administered. What's more, there is growing evidence that *all* residents of assisted multifamily housing, not only the Hard to House, benefit from the presence of concierge services or resident services coordinators to smooth the connections to schools, healthcare, employment and other basic needs of residents.⁴³

Currently HUD provides funding for Multifamily Resident Service Coordinators to HUD-supported elderly and disabled projects [Section 202, Section 8, Section 221(d)(3) below-market interest rate, and Section 236 developments] via three mechanisms: (1) a national competition with other properties for a limited amount of grant funding; (2) the

⁴³ Enterprise-Mercy Housing Study on Impact of Resident Services on Property Performance, April 17, 2007, <http://www.practitionerresources.org/cache/documents/645/64551.pdf>.

use of the development's residual receipts or excess income; or (3) budget-based rent increases or special rent adjustments.

While additional budget authority may be difficult to realize and allocate quickly to developments offering units for the Hard to House, HUD could readily allow residual receipts/excess income or budget-based/special rent adjustments to all such developments. Recognizing this operating cost as an “above-the-line” expense would also help encourage other non-HUD funders to recognize this as an acceptable standard in underwriting Hard to House units.

2. Influence & Coordination

Recommendation 9: As feasible, engage the Treasury Department, Congress, and states, in including Hard to House objectives in enhancements and applications of the Low Income Housing Tax Credit program.

The Housing and Economic Recovery Act of 2008 provided several helpful changes to the Low Income Housing Credit (LIHTC) program. Additional changes are being discussed for inclusion in the anticipated economic recovery bill in early 2009 to help free-up the stalled equity market and/or in larger tax-reform legislation anticipated later in the year. Although HUD has no direct policy or administrative control over the LIHTC program, it can help shape additional statutory and regulatory changes that would support the production of new housing for the Hard to House. A particular opportunity is to work with Congress and the Treasury Department to provide for the allocation of additional credits or a tax-credit bonus on a pro-rata basis for projects that include Hard to House units.

In administering tax-credit allocations, several state housing finance agencies already feature special set-asides of LIHTC authority, additional ranking points in applications, and/or “basis boost” provisions that effectively award special or supplemental credit authority to projects that include units for the Hard to House. For example, Louisiana incorporated a 5% Hard to House set aside as part of the additional LIHTC authority it was allocated under special provisions of the Gulf Opportunity Zone to deal with the affects of Hurricane Katrina. This effort has stimulated the rebuilding of New Orleans and surrounding communities while helping meet the pressing needs of those made homeless by Katrina. HUD could reward states offering these types of initiatives and encourage others to offer similar provisions by allocating some of its financing, subsidy, grant funding and/or regulatory waivers in tandem with such provisions.

Other changes proposed to the Low Income Housing Credit program by industry groups, including fixing the value of credits at a fixed rate of 4%, rather than at a floating rate; creating a refundable credit, and changes included in the Stimulus legislation, should be linked to the inclusion of Hard to House set-asides that would be matched by service and rent subsidy funds.

Recommendation 10: Incorporate support for the Hard to House in HUD-assisted economic development and Economic Recovery programs as feasible given project timing and readiness issues.

HUD is likely to have a prominent role in targeting some of its existing funding and any new housing-related funding to advance Economic Recovery projects in support of critical national priorities. Large scale infrastructure and mixed-use projects, particularly transit-oriented developments that create housing, are opportunities to build in set-asides for the Hard to House. *Where ready-to-go projects would not be delayed*, HUD could apply its funding and subsidy tools to increase the number of Hard to House units in these projects. It should encourage the inclusion of Hard to House units in all new projects and in all pending projects so long as already-approved planning, zoning, community review, underwriting and/or income tiering decisions and agreements would not have to be revisited.

C. Setting the Tone and Expectations

Successful approaches to integrating the Hard to House into mainstream existing housing and new mixed-income developments must be brought to scale. A significant challenge is that these efforts are not widely known and the perception persists that inclusion of the Hard to House will damage marketing efforts. HUD has an important role to play in publicizing successful models and encouraging more widespread adoption of housing models that include the Hard to House. Persuading real estate industry groups, private landlords, and developers, as well as other federal

agencies, of the urgency and inherent soundness of bringing these efforts to scale will require a strong and consistent message from HUD.

SUPPORTING LOCAL PLANS TO END AND PREVENT HOMELESSNESS

A. The Challenge

The Annual Homeless Assessment Report (AHAR) issued by HUD in July 2008 documented a 12% decrease in homelessness nationally and a 30% decrease in chronic homeless between 2005 -2007. This impressive progress can in large part be attributed to focus brought to homelessness by the “Ten Year Plans to End Homelessness” that over 400 communities have created. In 2000, the National Alliance to End Homelessness launched the Ten Year Plan effort to mobilize communities to assess the scope of homelessness in their town or city and to implement evidence-based solutions, notably supportive housing. During the Bush Administration, the U.S. Interagency Council focused its attention on this effort as well, with an emphasis on chronically homeless persons. These efforts guided communities in understanding the economic realities of homelessness, including recognizing that housing is not only the assistance most sought after by homeless persons but the most cost effective use of government, philanthropic, or investment dollars.

Though there is much work to be done to reduce homelessness among families and the Hard to House, progress on chronic homelessness has been remarkable, even as the nation braces for new waves of homelessness created by home foreclosures, job losses, and returning Iraq and Afghanistan veterans. The reduction in chronic homelessness, resulting from a concentrated national effort, shows what is possible when a focused strategy is employed to house a Hard to House population. HUD has an instrumental role to play in broadening this success; in sustaining the gains made in recent years; and in preventing new homelessness at a volatile moment in history. It is a time for bold action.

B. Recommended Directions

1. Investment

Recommendation 12: Fully fund the implementation of ten high quality Ten Year Plans. Treat these communities as laboratories for testing new strategies and bringing proven approaches to scale. Enable each community to draw up to \$20 million in new resources to fully implement their plans.

Some Ten Year Plans are better than others; all are under-resourced. Embedded in some of these plans are powerful ideas that have yet to be implemented and could be enormously important for instructing other communities and guiding future federal, state and local policy, and investment.

Recommendation 13: Finish the job of ending chronic homelessness. Direct HUD resources toward housing the 127,000 remaining chronically homeless and creating 90,000 additional units of supportive housing nationwide.

The 2007 AHAR identified that 127,000 adults still remain trapped in chronic homelessness. A first-year goal of the new administration should be finishing the job of housing these individuals. This will require HUD’s leadership and the comprehensive effort described throughout this report.

Those who are now chronically homeless need to be matched with housing, rental assistance, and support as rapidly as possible. Most communities now have some experience with “housing first” approaches, moving the chronically homeless directly into housing, and adjusting the support services to whatever is needed to keep these individuals housed. Though spread throughout the country, the largest concentrations of chronically homeless adults are in California, Texas, and Florida. HUD’s regional offices in those states should be particularly engaged in this effort.

To assist the highest-need segment of the Hard to House, supportive housing has proven to be critical. Over 60,000 units have been created nationwide, of the 150,000 units believed to be needed. Creating the remaining 90,000 supportive housing units, in congregate and scatter-site settings, should be a goal of HUD’s investments.

Recommendation 14: HUD should partner with the Department of Veterans Affairs to expand the VASH program and develop housing for Hard to House and other veterans at their campuses throughout the country, using HUD financing, insurance programs and technical expertise:

A particular challenge in the coming years will be the housing needs of returning veterans and their families. It is estimated that as many as 50,000 units of affordable housing linked to support will be needed to provide for Hard to House disabled veterans of the wars in Iraq and Afghanistan.⁴⁴ The VASH program should be expanded to meet all demonstrated need, with modifications to the program to allow project basing of Section 8 vouchers and for services to be contracted to community organizations.

The experience of veterans of prior wars, who become homeless in disproportionate numbers, makes it clear that aggressive steps are needed to avoid a new tragedy. Nationwide, the Department of Veterans Affairs operates hospitals and mental health and addiction services but not permanent housing for struggling veterans. Most of their support services are located within large campus-like settings with significant underutilized space. The VA has completed extensive studies of its holdings, but relatively few re-use plans have moved forward. Housing for Hard to House and other veterans should be created at these campuses. We can imagine a catalytic role for HUD in partnering with the VA to create re-use strategies for these campuses featuring housing for a new generation of veterans and older veterans with housing needs.

Recommendation 15: Align Continuum of Care process with Ten Year Plans.

HUD's current funding for the homeless is channeled through the "Continuum of Care" (CoC) process. There was an active discussion within our group about the CoC. Much energy has gone into negotiating a new bill that will be taken up in the next Congressional session and there is reluctance to undermine its chances for successful passage. However, there are significant problems with the design of the existing CoC process.

The CoC framework predated the development of communities' Ten Year Plans, which have become the driving force for progress in reducing homelessness. Regrettably, in communities which have Ten Year Plans, the CoC process does not always overlap with these efforts. CoC funds go directly to local not-for-profits through a decision-making process that is dominated by representatives of the not-for-profits who receive the CoC funds. Only thirty percent of CoC funds are required go to supportive housing, for example, despite housing being the overwhelming need in communities. Understandably, interest in maintaining program funding can conflict with new investments called for in a community's plan.

It is also the case that the Ten Year Plans are of uneven quality and that not every community has a plan. Thus more important than the specific mechanism, a Ten Year Plan or the Continuum of Care, are a disciplined focus on housing outcomes and reduced homelessness in allocating new or renewal funding. We urge HUD to base its McKinney-Vento funding decisions on how many chronically homeless persons and other Hard to House homeless households will be housed as the result of the investment made and to review contract performance accordingly.

The goal is clear: HUD homelessness funding should support a uniform community strategy that focuses on housing rather than shelters or other short term assistance. While HUD examines the role of the CoC, there are administrative measures that could better align CoC funding with Ten Year Plans in those communities where both are operative. HUD should announce its expectations that these plans be aligned and focus on housing.

As part of the analysis of CoC funding, HUD will discover a simmering conflict between the need to renew rental subsidies funded through the CoC process and meeting "new needs" out of the same limited pool of funds. Moving all subsidy renewals to Section 8 would be a sensible direction.

If HUD undertakes the initiatives we recommend, we believe that the landscape of homelessness will dramatically improve.

⁴⁴ National Alliance to End Homelessness

2. Regulation

Recommendation 16: Adjust McKinney-Vento eligibility criteria to preserve access to housing and services for the formerly incarcerated who were chronically homeless or homeless prior to incarceration.

An important technical change is needed in the eligibility criteria for McKinney-Vento to allow access to housing and services by the formerly incarcerated. Those who were chronically homeless prior to incarceration should continue to be considered chronically homeless following their release. Similarly, those who were homeless prior to jail stays should continue to be regarded as homeless upon release. In granting this relief, HUD and the White House should encourage “justice re-investment” practices by states and counties to shift some portion of savings achieved in correctional, healthcare, and shelter systems into housing-linked services matched to HUD’s housing investments.

Recommendation 17: Create incentives for communities to identify the homeless who are at greatest risk for premature death, who have been trapped in homelessness the longest, and who are the most costly to public systems. Allow communities who have systematically identified these individuals to obtain waivers from standard HUD marketing procedures in order to prioritize these Hard to House households for housing placement.

While all households who fall within our Hard to House definition have more difficulty than other poor households in accessing suitable housing, even within the Hard to House populations are households of especially great need. Three groups are of particularly urgent concern: those homeless individuals whose health is so impaired that the absence of a stable home is actually life threatening; those who are the frequent users of emergency and institutional services, who not only lead very compromised lives but account for sizable and unnecessary costs and burdens to publicly funded services; and the chronically homeless on streets and in shelters, who symbolize the failure of our efforts to provide a suitable home for all Americans. There is considerable overlap among the three groups.

Communities should be required to identify these individuals and families, who, despite the frequency of their encounters with public systems and the extremity of their need, typically fall between the cracks. More and more communities are now reviewing system data to identify frequent service users and matching data across shelters, jails and emergency rooms to identify the Hard to House who are having the greatest impact on public institutions. A growing number of communities are paying attention to those living on the street and in shelters for prolonged periods and recognizing the public health implications of having many chronically homeless who are suffering from chronic illnesses.

Once identified, these individuals and households should be prioritized for housing. But HUD marketing regulations discourage targeting. We recognize the risks inherent in moving away from blind lottery systems and waiting lists in distributing the scarce goods of subsidized housing. We believe, however, that it is sensible and necessary to acknowledge and accommodate priority households to save lives and assist overburdened and unnecessarily costly public systems. We suggest that communities identify and maintain housing priority lists based on the specific criteria we describe and that they submit those lists to HUD as a condition for receiving waivers from standard marketing procedures.

C. Setting the Tone and Expectations

HUD’s role in addressing homelessness needs to be more coherent and direct.

HUD’s leadership is essential to the work of ending homelessness and to implementing on a broad scale the targeted, housing-based strategies that have been shown to successfully reduce homelessness. Much of the hard work has been done: hundreds of communities believe that ending homelessness in their town or city is possible and urgent. They will be listening for HUD to echo their belief, to make evidence-based funding decisions, and to support their local plans.

HUD can help communities be successful by integrating the resources of federal agencies, facilitating the integration of Hard to House households into mainstream housing, and supporting local plans. It should also be the standard bearer for a renewed national effort to end homelessness, and challenge itself and all those in the housing community to build on the progress achieved and complete the task.

CONCLUSION

Recommendation 18: As a final recommendation, a plan for evaluation of major new initiatives should be designed and implemented so as to enable federal officials to track the work underway, to identify and communicate successes, and to make course corrections as needed.

**PART 2:
REINVIGORATING PLACES –
NEIGHBORHOODS, CITIES, SUBURBS,
AND METROPOLITAN AREAS**



RETOOLING HUD

for a CATALYTIC FEDERAL GOVERNMENT:
a REPORT to SECRETARY SHAUN DONOVAN

Penn Institute for Urban Research
University of Pennsylvania

CHAPTER 4

IMPROVING COMMUNITIES IMPACTED BY FORECLOSURES

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

The current economic crisis has its roots in the unprecedented increase in home mortgage foreclosures. While clearly there are millions of individual “victims” of this crisis, the consequences of the mortgage meltdown go far beyond those property owners facing foreclosure. America’s neighborhoods are at risk as the torrent of foreclosed properties undermines the value of property in every region of the country and threatens the integrity of our neighborhoods everywhere.

This paper is intended to suggest some immediate and long-term strategies to mitigate the effect of the current crisis.

SUMMARY OF PROPOSED STRATEGIES

We suggest a multi-faceted approach to addressing both immediate and long-term issues arising from the foreclosure crisis. This summary will provide a brief overview of the areas addressed and the key recommendations in the paper.

A. Rethink the provisions of the Neighborhood Stabilization Program (NSP)

1. *Increasing the effectiveness of the U.S. Department of Housing and Urban Development (HUD) NSP:* We recommend a series of steps, ranging from recommendations for rule changes to proposals for additional funding to make the NSP a more powerful tool for revitalization.
2. *Necessary Tools for Neighborhood Recovery:* We recommend a series of additional tools, including Federal Housing Administration (FHA) mortgage products, strategies to leverage public and private financing and to enhance state housing finance agency capabilities, and initiatives to more comprehensively foster neighborhood recovery.

B. HUD should commit to a “Code of Conduct” as owner and seller of foreclosed real estate owned (REO) property

Rather than setting the standard for responsible ownership of vacant REO property, HUD has earned a reputation for being as irresponsible an owner and seller as many private lending institutions. HUD must lead by example with respect to the management and disposition of REO property.

1. *Address the excess supply of properties resulting from foreclosures:* HUD should build local capacity to design and implement land banking activities, with particular focus on inter-jurisdictional cooperation.
2. *Improve access and identification of the foreclosed property inventory:* Develop a national data base of foreclosed properties, and use HUD funding to incentivize states to adopt laws requiring timely recording of property transfers through foreclosure.
3. *Reform local and state policies:* Tie HUD funding to effective reform of tax foreclosure, mortgage foreclosure and other procedures at the state and local level, while providing HUD resources to build local capacity and upgrade critical local efforts, such as code enforcement.

4. *Change the redevelopment environment:* A series of major steps is needed to create an environment in which neighborhood stabilization can become a reality.
 - Build strong public-private partnerships focused on specific accountability and outcomes – provide new incentives for investment and revitalization, working through a revised and enhanced NSP program, and a new, neighborhood-oriented version of HOPE VI.
 - Rebalance housing supply and demand in distressed neighborhoods to measurably reduce inventory of abandoned homes while increasing consumer demand for area housing – provide resources and capacity building assistance to enable distressed older cities and neighborhoods to restore their vitality as smaller, stronger communities.

BACKGROUND

Many American cities – particularly those in traditional eastern and mid-western “rust belt” areas – have suffered for decades from slow growth and weak real estate markets resulting from shifts in industry, jobs, and population. Remarkably, in the face of these underlying challenges, America’s civic, community and philanthropic leaders fought back and over the past four decades have built a community development system that has led to improvements in many of these cities and their neighborhoods. A network of thousands of community development corporations (CDCs) has evolved in partnership with city governments, churches, foundations, grassroots leaders, financial institutions and businesses. Supported in large part by HUD and Community Development Block Grant funding, CDCs have been responsible for tens of thousands of units of new and renovated housing, new retail, playgrounds, and recreation centers. They have created jobs, reduced crime and provided home repair resources for homeowners. They have pioneered the development of new tools for rebuilding communities: homeownership programs, scattered site lease-purchase programs, tax-credit financing for affordable housing, Model Block programs, Housing Courts, and the resurrection of ancient legal remedies such as Receivership for abandoned houses.

What few realized was that while great strides were being made to revitalize neighborhoods and stimulate neighborhood housing markets, while new housing starts were increasing, while private developers seemed to have re-discovered neighborhood markets once abandoned, while new homebuyers were rediscovering the attraction of city living, a cancer was taking root. That cancer, which first emerged around 1995 but grew exponentially from 2004 to early 2007, was a growing network of mortgage brokers, upstart mortgage lenders, and investment banks engaged in irresponsible and largely unregulated mortgage lending and investing.

This crisis is now undermining 30 years of locally sponsored accomplishments and investments. A community development production system that once could generate nearly 100,000 units of housing per year (according to the NCCED 20005 Community Economic Development Census) has now been brought to a standstill. Neighbors who never had a vacant house on their street now have 2 or 3. Blocks which may have had 1 or 2 vacant houses from time to time, now have 5, 10 – even 20. Tragically, while the community development system was injecting value into the front door of American neighborhoods, subprime lenders were mining it and extracting it out the back door.

The growing inventory of foreclosed and abandoned homes – estimated, for example, at present to be 9,000 in Cleveland and over 20,000 in Detroit – has negative effects that are undermining the investments made by HUD, local government and private philanthropy. The following is by no means an all-inclusive list of the costs to urban communities:

- Lost market value for homeowners who live near a foreclosed vacant house.
- Inability of homeowners to sell or to refinance for home improvement and repair.
- Lost property tax revenue from devalued real estate.
- Budget cuts to schools, police, and fire departments from lost property tax revenue.
- Municipal costs to board-up, secure, and often re-secure vacant homes (est. \$1,000/home).
- Municipal costs to demolish unsalvageable homes (est. \$10,000/home).
- Increased municipal costs for additional police, fire, and other city service calls to abandoned homes.

For those vacant properties that are salvageable, the cost of rehab and renovation now requires public subsidy that would not have been required prior to this crisis. In Cleveland, for example, a home that typically costs \$125,000 to

renovate (all-in costs for acquisition, rehab, soft costs and development fees) would have sold for \$125,000 five years ago. The same house, with the same level of rehab and cost, may now not even sell for \$80,000 on the same street – because of the nearby proliferation of abandonment and blight and the reduction in appraised values that result from abandonment.

Banks holding thousands of vacant REO properties are complicit in this debacle. As the realization has dawned that they are sitting on growing inventories of properties that represent a substantial legal liability, many have begun the practice of wholesale “dumping” of the properties to private speculators and flippers who are doing little to improve these properties and neighborhoods. This unhealthy practice only exacerbates the costs that local officials face in controlling abandonment and blight.

Virtually every penny of housing wealth gained since 2004 has now been lost. As Figure 1 shows, at the same time that the Case-Shiller Home Price Index dropped by more than 20% since its peak at the 2nd quarter of 2006, the unemployment rate has risen more than 32%. Although newer data on the home price index are not yet available, more recent unemployment rate data show that between September 2008 and December 2008, the unemployment rate rose another 1.0 (16.1%) percentage points translating to nearly 1,500,000 additional unemployed workers.

Actual sales and sale prices are plunging. According to the National Association of Realtors, sales of existing homes are down more than 10.5% since last year and sale prices of those existing homes is down more than 13.0%. The median price of existing homes dropped 9.0% nationally since last year and more than 21% in the west. New home sales are down more than 40% in the last year and the trend of housing starts is down 38%. The Joint Economic

Committee estimates that real median prices have fallen from \$260,734 in 2007 to \$231,855, which is an 11% decline. States like Arizona (27% decline), California (16.9% decline), District of Columbia (18.4% decline), Florida (20.9% decline), New Jersey (17.3% decline), Nevada (31.9% decline), Rhode Island (18.6% decline), and Utah (16.5% decline) have been hit especially hard. Only 15 states experienced increases and those increases were no more than 3.9% (Montana) – typically far less. Aggregate lost housing wealth owing to that decline stands at more than \$2.6 trillion.

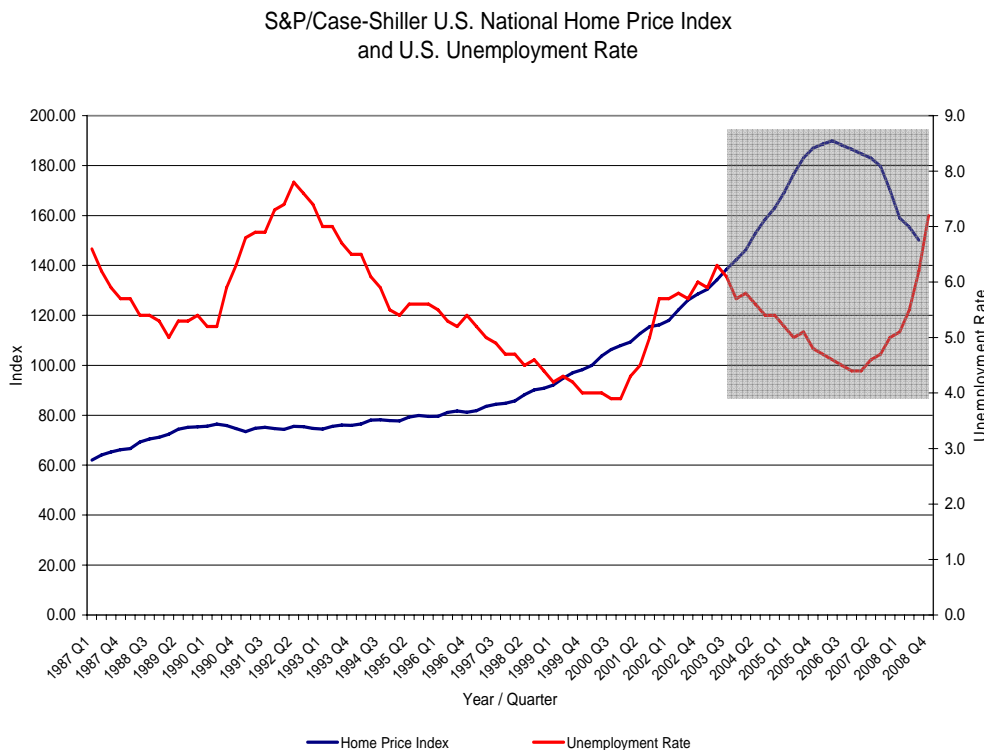


Figure 1

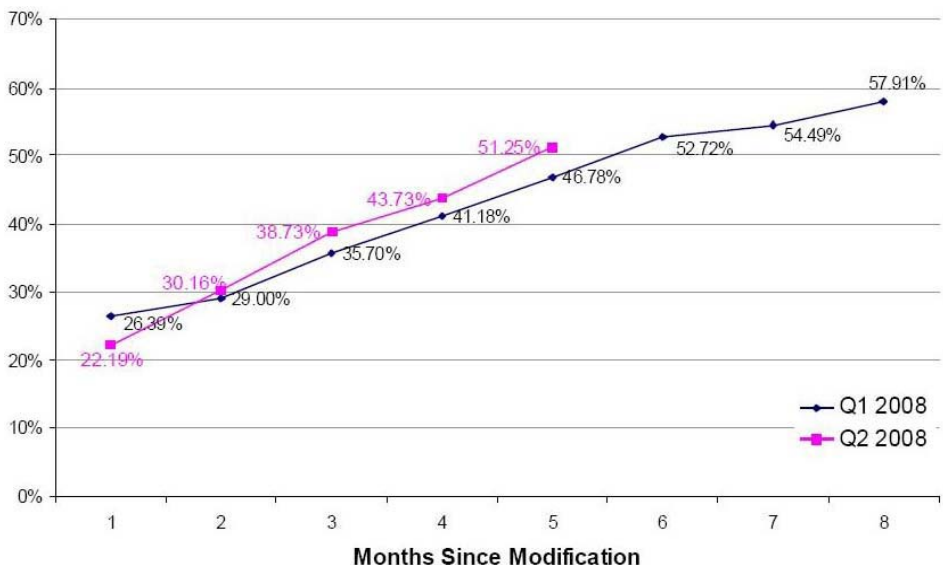
The Federal Reserve reports that as of the third quarter of 2008, the debt service ratio (i.e., DSR, debt payments as a percent of personal income) stood at 14.01%; although the DSR has been slightly higher in the last two years, that ratio is on a long term trend up. The same can be said of recent homeowner DSRs which now stand at 17.64%.

Foreclosure numbers over the last few years have soared and show no signs of abating. According to the Mortgage Bankers Association of America (MBAA), between the third quarter of 2005 and the third quarter of 2008 (the most recent data available), the number of delinquent loans rose from 1.87 million to 3.32 million and the number of loans in foreclosure rose more than three-fold from 395 thousand to 1.35 million. This is likely an understatement of the problem because MBAA data cover approximately 80% of the mortgage market. Mark Zandi of Moody’s

Economy.com reports that the number of first mortgage defaults rose from 800,000 in 2005 to 2.65 million in 2008. Zandi argues that if home prices were to decline just another 10%, some 18.6 million homeowners will be underwater (i.e., they will owe more on their mortgage than their home is worth). Zandi predicts that an additional 8.5 million homeowners will default in the next three years and an estimated 5 million households will lose their homes. With debt and unemployment on the rise, coupled with declining home prices and increasing numbers of homeowners underwater, it is not surprising that foreclosures are now at epidemic proportions.

Census data on housing vacancies reflect the problem – although the full impact of foreclosures is not yet seen in these data. Homeowner vacancy rates stood at 2.8% in the third quarter of 2008. A rate this high is not recorded by the Census in data going back as far as 1960. Rental vacancy rates stood at 9.9%, which is among the highest rates ever recorded (again, going back to 1960). Cities, in particular, are feeling the pain of owner vacancies. While suburban and non-metro areas have owner vacancy rates of 2.4% and 2.6% respectively, the city rate is 3.5%. American Community Survey data for 2007 show hyper-vacancy rates in some cities (e.g., 33% in Detroit, 26.5% in Baltimore, 30% in Cleveland, 16.3% in Chicago, 17.5% in Philadelphia).

Although experts may differ about actual amount of loss and the portion of the loss that can be attributed directly to mortgage foreclosures, it is incontrovertible that the cumulative cost to the country is staggering. The Joint Economic Committee estimates that the total loss of property value attributable to subprime loans is \$103 billion, of which \$70.8 billion is directly due to foreclosures and \$32.2 billion results from the impact on surrounding properties. Total property tax loss, attributable to subprime loan foreclosures, is \$917 million of which \$600 million is directly due to foreclosures and \$317 million is from the depressed values of surrounding properties. As a rule-of-thumb, the limited academic literature suggests that about \$1,000 of a home’s value is lost for every foreclosure within an eighth of a mile. Take as an example the neighborhoods in Philadelphia shown in Figure 2. Each red dot is a foreclosure. Every resident in those neighborhoods are living in homes with values that have been significantly depressed – even if that person is fortunate enough to remain current in all of his/her financial obligations.



Making matters worse, loss mitigation efforts to date are not evidencing great results. The OCC-OTS reports that default rates for borrowers whose loans were modified are unacceptably high – for loans modified in the first quarter of 2008, 19.2% were 60+ days delinquent after just three months and if we look out six months, the rate rises to 36.9%.



Figure 2: Mortgage foreclosures in two Philadelphia, PA neighborhoods

TACKLING THE PROBLEM

The United States is being ravaged by a foreclosure epidemic. It is not only undoing the savings, assets and hopes of millions of American families, but it is devastating neighborhood after neighborhood, turning areas that were once stable or improving communities into destabilized ones, with rising crime rates and plummeting property values. With projections as high as 8 million mortgage foreclosures by 2012 (Credit Suisse) and the economy continuing to shrink, the effect of this epidemic is such that, unless it receives a forceful federal response, it will undermine the vitality of our towns and cities for decades to come. By that point, the collective wealth of the American people will have been reduced not by billions, but by trillions of dollars.

Addressing the issue, however, is not a simple matter. For example, a local community development corporation that acquires and rehabilitates 50 houses in its neighborhood may find its efforts in vain if, while it is laboring at that task, 150 houses in the same area are foreclosed upon and subsequently abandoned. As we see it, addressing the problem requires dealing simultaneously with four distinct dimensions:

- Reducing the number of future foreclosures.
- Gaining control of the overhang of problem properties in default, foreclosure or REO inventories.
- Restoring problem properties to productive use.
- Developing public-private partnerships to stabilize neighborhoods, towns and cities.

These four dimensions are totally inter-related; we cannot expect success in any unless we deal with all.

In doing so, there is no even remotely plausible alternative to a strong, aggressive, federal role. First, no state or local government, and certainly no community-based group or private, for-profit entity, has even a fraction of the resources necessary to have a modest impact on these problems. Only the federal government, for all the competing demands on its resources, can marshal enough resources to address these issues in a serious and potentially effective fashion.

Second, by making federal resources available and by conditioning their distribution on responsible, reciprocal partnerships with state and local government, the federal government can bring about changes in laws, regulations, and procedures that will significantly mitigate the problems and enhance the effectiveness of the resources being made available.

Third, no other entity is in a position to motivate the financial system in the manner needed to effectuate change. Reducing the number of future foreclosures and gaining control of problem properties is partly a matter of money, but also one of changing the rules so the financial institutions controlling those mortgages and properties will take the actions that are needed, whether through amending the bankruptcy law or taking other steps to motivate lender decisions.

A. Rethinking the Neighborhood Stabilization Program Provisions

This Task Force recommends a two-staged plan for HUD and the Obama administration to improve the effectiveness of community stabilization efforts in distressed neighborhoods.

Stage one recommendations include statutory and regulatory improvements to the current HUD-administered Neighborhood Stabilization Program (NSP) that could be implemented within the first 90 days of the new administration. Stage two recommendations include new programmatic solutions that would complement NSP and further enhance community stabilization efforts over the next few years.

Stage One – Increasing the Effectiveness of the HUD NSP

Below are some specific recommendations that will enhance the effectiveness of the current NSP initiative.

Recommendation 1: \$5 Billion in NSP funding.

The Secretary should request an additional \$5 billion in Neighborhood Stabilization Program (NSP) funding. The campaign to reclaim deteriorating neighborhoods in the wake of high levels of foreclosure and abandonment will take many years. Many state and local government grantees currently view the initial \$3.9 billion made available as part of the Housing and Economic Recovery Act of 2008 (HERA) as a one-time allocation of Community Development Block Grants funding designed for a special purpose, rather than the beginning of a multi-year new program to address the current and on-going crisis.

An additional \$5 billion made available quickly in 2009 will reinforce the need to build a sustainable strategy and to develop comprehensive, collaborative initiatives to arrest neighborhood decline. It will also increase the likelihood that sufficient additional resources can be dedicated to successfully stabilize target markets.

The NSP will serve as more than a bricks-and-mortar solution. It will also help revive the economy, generating considerable skilled and unskilled jobs in the construction trade and in other housing and economic development positions located in low- and moderate-income neighborhoods.

Recommendation 2: National Community Stabilization Trust Support.

The Secretary should seek significant funding for risk capital and working capital to be implemented by the National Community Stabilization Trust (NCST), the nonprofit LLC created by Enterprise Community Partners, the Local Initiatives Support Corporation (LISC), Housing Partnership Network and NeighborWorks America.

With this funding, the NCST will significantly expedite and expand the impact of NSP dollars in communities across the nation. The proposal, now being considered on the Hill, recommends funding for *risk capital* to enable the NCST to leverage billions of dollars of capital from mortgage lenders, national financial institutions, state and local housing finance agencies, philanthropic entities, CDFIs, and other sources. This new capital will be used for credit enhancements, loan guarantees, and direct lending for ownership and rental housing, significantly increasing the impact of NSP funding in participating communities. The funding would also facilitate more efficient public-private

lending for acquisition and renovation, greatly expanding the number of properties acquired, renovated and put back to productive reuse.

The NCST plan also calls for *working capital* for state and local governments and local nonprofit housing providers that will need to quickly build the expanded infrastructure to acquire and manage assets, obtain land-banking capabilities, rehabilitate deteriorated properties, prepare new property owners, and conduct a myriad of new and expanded tasks at an unprecedented scale. As such, HUD would oversee the establishment of a working capital fund that would provide capital grants through the NCST to local housing providers and units of state and local government. The funds would be designed to hire the staff, obtain the technology, and build the processes on an accelerated basis to meet the crisis at hand.

In addition, there is currently no capacity-building or training funding designated for NSP. HUD should seek capacity-building funding sufficient to increase local expertise in program design, financing, construction management, and asset management. As a rule of thumb, historically one percent of the HOME Investments Partnership Program (HOME) is designated for such purposes. For NSP, a \$5 billion appropriation in 2009 for NSP would suggest a \$50 million technical assistance budget.

There are currently over 300 state and local grantees receiving NSP funding. The risk capital and working capital funding being proposed will arm local housing providers with the tools necessary to successfully use the \$9 billion (\$3.9 billion and additional \$5 billion) of NSP funds, while generating at least 100,000 jobs in the process.

Recommendation 3: Change the NSP funding approach.

The original \$3.9 billion has been allocated through a needs-based formula that reflects the numbers and rate of foreclosure(s), subprime loan originations, and defaulted loans. In addition, 52% of the money was allocated to states, with 18 states receiving a minimum amount of \$19.6 million. Heavily impacted states such as California, Arizona, and Florida received large state allocations and large local allocations. For example, while the state of Florida received \$91 million, 47 cities and counties in Florida cumulatively received over \$400 million in separate allocations, including \$62 million for Miami-Dade.

While the formula has appropriately resulted in funding going to highly impacted locations, it has also resulted in large allocations to small localities that have little experience or dedicated staff to currently address the problem, while effectively underfunding other communities with considerable capability that have limited the growth of foreclosures. Moreover, many state agencies are passing through the NSP allocations to small cities that do not have existing housing and community development capacity.

The current method of distributing NSP funds through a needs-based formula allocation should be revisited. While funds should continue to be provided to states and localities experiencing high rates of foreclosure and abandonment, additional factors such as local capacity, public-private collaboration, comprehensive, and concentration (targeting) of the stabilization effort should be encouraged. Moreover, HUD should proactively encourage better leverage of these dollars with other sources of capital and encourage creative, innovative approaches. As a result, it is recommended that any additional NSP funding provided by Congress in 2009 should be allocated to state and local governments based on a competitive process that reflects need and capabilities. Any such competitive process should be implemented by HUD in a timely manner given the urgent needs in our communities.

Recommendation 4: Program income and affordability rules.

The current program income rules, as legislatively drafted and as currently interpreted by HUD, create draconian and counter-productive NSP requirements that discourage homebuyer and investor interest in these declining markets. Currently, program income generated from NSP activity received after 2012 must be repaid to the federal government.

Program income rules, as currently interpreted by HUD, treat rental property revenue as “program income” and hence subject to recapture. This precludes rental investment in some markets and creates property management problems for nonprofit and for-profit owners in all markets.

In addition, resale of rental and homeowner properties is also subject to the current NSP program income rules. Any income to be derived from rental operations or any income to a seller of a property because home values appreciate

after 2012 must be repaid to the federal government. The whole premise of stabilizing neighborhoods is to attract people to live there because, in part, they understand it is both a good place to live and a good investment. The perverse provision currently in the NSP, that the federal government will be the beneficiary of any equity built through owner appreciation, is a major disincentive to homebuyers and further lessens demand for housing in these neighborhoods.

There is a related problem regarding the preservation of affordability that is also creating an obstacle to neighborhood recovery. The statutory requirement that NSP assisted-properties remain affordable to the maximum extent practicable for future owner's is resulting in many NSP grantees structuring counter-productive limited equity or shared equity homeownership approaches, which further limit buyer demand. In order to preserve housing affordability, HUD is currently only permitting an approach where the property resale price is restricted. This provision could be better met by offering two options: either a *recapture* mechanism, where the homebuyer would be obliged to repay the assistance upon sale of the property with a prorated reduction for the time the owner has owned the property, or by a *resale restriction*, which preserves the unit's affordability by limiting a prospective owner's equity.

The statute should be amended as quickly as possible: 1) to eliminate the requirement that equity proceeds from the sale of the property must be repaid to the federal government (after 2012); and 2) to clarify that the preservation of property affordability can be satisfactorily met by applying the provisions already established for the HOME Investment Partnership Program. The HOME program provisions permit both the recapture and resale restricted approaches.

Recommendation 5: Property valuation requirements.

HUD has determined that a full market appraisal consistent with the Uniform Relocation Act must be obtained when NSP funds are being used. Acceptable alternative forms of valuation, as permitted by the Appraisal Institute, should be permitted.

In addition, HUD should issue guidance to NSP grantees regarding how to establishment property value discounts from the appraised value. The discount provision has become unnecessarily complicated. Moreover, the use of a "net realizable value" for the transfer of property should be considered an appropriate means of obtaining an eligible discount.

Stage Two – Necessary Tools for Neighborhood Recovery

Neighborhood recovery is a complex, multi-faceted challenge. Aggregating REO, improving the properties, managing property assets, conveying property to new buyers, and identifying responsible new mortgage products are essential components. But doing it right will save more neighborhoods and generate lots of jobs in the process.

Below are promising new programmatic approaches that can increase the effectiveness of community recovery activity and complement the current Neighborhood Stabilization Program.

Recommendation 6: Property acquisition/renovation product.

HUD should develop a "renovation reserve fund" to facilitate scalable property rehab financing for the conventional lending community.

Lenders do not like originating purchase mortgages or refinanced mortgages when renovation is part of the financing. With the exception of the FHA 203(k) program, there is no meaningful level of purchase/rehab mortgage money available in the mortgage marketplace.

When originating such a mortgage, the lender assumes renovation risk that is beyond its control. Further, a lender cannot easily sell the mortgage with this contingent risk. Fannie Mae and Freddie Mac require a recourse provision, which necessitates a lender repurchase should anything go wrong with the renovation of the property (cost overruns, construction deficiencies, after renovation valuation problems, etc.). This contingent liability precludes purchase and renovation as a viable form of financing. As a result, NSP money is being used too extensively to pay for property rehabilitation as a separate undertaking from the REO purchase, an ineffective and expensive use of scarce resources.

A national *renovation reserve fund* capitalized by the federal government would insulate the lender from some or all of the rehab related risk, allowing lenders to originate purchase/rehab loans in much the same manner as a purchase mortgage. Similar approaches have been used successfully on a pilot basis by the government-sponsored enterprises (GSEs) in the past.

Recommendation 7: States and credit enhancement.

States receive half of the NSP money. As previously mentioned, too often this funding is simply passed through to small cities consistent with CDBG policies, or provided to existing local NSP grantees.

If states are to receive such large allocations in future NSP allocations, consideration should be given to changing their role to better leverage the NSP dollars. This could be accomplished by more formally engaging the state housing finance agencies, by necessitating a strong state financing role, or by permitting credit enhancements for certain forms of lending such as acquisition/rehab financing, small rental property acquisition, land banking, and the like. Such activities are difficult if not impossible to structure in a sustainable manner at the local level, but states could spread the risk among grantees and, in the process, leverage more conventional mortgage money from lending institutions.

Recommendation 8: Home equity protection program.

In distressed and declining markets, HUD should more proactively encourage new buyers to invest in property. That can best be accomplished by leveling the playing field with other stronger markets. Homebuyers and responsible investor owners of rental property will invest where the financial decision is the most advantageous. Right now, that is certainly not a distressed market.

So, how to level that playing field? By creating an assurance that the new buyer can receive all upside benefits of a rejuvenated neighborhood – property equity – while at the same time guaranteeing that they will not lose their down payment or any funds invested in property improvements. In effect, this *Home Equity Protection Program* guarantees buyers that if the housing market does continue to decline in the area where they live, they will be protected for part or all of that loss.

This model was piloted in Syracuse earlier this decade. It was designed to encourage investment in inner city neighborhoods, rather than first-time buyer investment in the suburbs. It is time to consider a broader application of the approach, given the crisis impacting our neighborhoods. Cost of the protection would be shared between the federal government and participating property buyers who pay a premium for the insurance.

Recommendation 9: Workforce housing incentives.

HUD should encourage employers to become more engaged in place-based housing efforts, particularly in declining markets. This could take the form of tax credits for investment in declining markets, creation of mortgage vehicles where employers provide securitized soft seconds tied to continued employment, or similar incentives.

Recommendation 10: Lending institution Community Reinvestment Act (CRA) credit

The CRA has been a consistent, positive factor driving investment, lending and other services in low- and moderate-income neighborhoods. The Secretary should work with the regulatory agencies to clarify CRA guidelines to provide additional CRA credit where the financial institution is 1) providing REO property in a systematic and affordable manner in furtherance of neighborhood stabilization activities; 2) providing loss mitigation services to existing borrowers in a manner that is preserving homeownership; and 3) managing its current and future REO portfolio in a manner that maintains the property in good condition consistent with all state and local code requirements.

Recommendation 11: HUD should commit to a “Code Of Conduct” as owner and seller of foreclosed REO property.

As the mortgage foreclosure crisis continues to evolve, the manner in which lending institutions manage their obligations as owners of post-foreclosure REO (“Real Estate Owned”) property is also evolving. It is becoming increasingly apparent that many institutions, faced with an ever-growing inventory of vacant property, are finding they cannot re-sell these properties for the value they expected to recover. The sheer volume of foreclosures initiated by lending institutions now means that every new foreclosure is likely situated on a street where there are already other foreclosed, vacant and blighted homes. In some communities particularly hard-hit by foreclosures, property values have dropped dramatically and foreclosed property – often vandalized and stripped of plumbing and other mechanical equipment – is worth nothing close to the amount of loss sought to be recovered.

As the magnitude of this problem has become apparent, lending institutions have begun changing their REO sales practices and are increasingly engaged in sales to flippers and speculators at bargain-basement prices, essentially “dumping” properties as quickly as possible in order to avoid compliance with local municipal housing codes. The damage to local communities is perpetuated when the buyers of these properties fail to maintain and occupy them.



Photo Credit: Frank Ford

An example from Cleveland illustrates this problem.

2620 E. 114th Street – foreclosed by Wells Fargo and bought at Sheriff Sale 3/24/06. Sold by Wells Fargo to an investor 2/28/08. Cited for code violations by the City of Cleveland 8/14/08 and now condemned. Cited for board-up costs by City 11/14/08.

2616 E. 114th Street - New home built by the Buckeye Area Development Corporation in 2004 and sold to a homeowner for \$141,000. Estimated present value due to blight next door = less than \$100K.



Photos Credits: Frank Ford, 12/28/08, 5:15PM

2620 E. 114th (on left) as of 12/28/08 still abandoned by HUD purchaser 10 months later.



Padlock on front door broken – open to casual entry

HUD has been an insurer of mortgages for many years. However, it now appears that since the early 2000s HUD insured many unsafe and unsound subprime loans. Tens of thousands of these troubled loans went into foreclosure resulting in HUD becoming the owner at Sheriff sale consistent with terms of the mortgage insurance contract. [change here b/c otherwise sense is that HUD’s becoming a major owner of vacant property is a *response* to the serious problem, rather than a version of it] HUD has now become a major owner of vacant foreclosed property in urban communities.

In Cleveland, for example, HUD is the largest owner of foreclosed REO property in the County, with 1,466 foreclosed homes, exceeding even Deutsche Bank, Wells Fargo and others. In the City of Cleveland proper HUD is the second largest holder at 707 properties, second only to Deutsche Bank which holds 746.

Unfortunately, rather than setting the standard for responsible ownership of vacant REO property, HUD has earned a reputation for being as irresponsible an owner and seller as many private lending institutions. Common complaints about HUD from local government officials, as well as from community development practitioners, include:

- Failing to maintain properties in safe condition.
- Failing to screen buyers to avoid sales to flippers and speculators.

- Selling to buyers who perpetuate disrepair.
- Failing to file deeds indicating that HUD has become the owner.
- Failing to appear in court when HUD properties are cited for code violations.
- Allowing delinquent taxes to pile up, paying them only upon sale of the property.

One example would be the house pictured below, at 3451 E. 70th in Cleveland, which HUD acquired on 5/22/06 at a Sheriff Sale. The house has sat vacant for over two years, has been the subject of neighborhood complaints and has been cited numerous times for code violations. HUD received notice of these violations. Cleveland City Councilman Anthony Brancatelli notified HUD that the property was now condemned by the City and asked HUD to demolish the house. Instead, HUD sold this property, along with 3 other condemned houses, to United Management & Investment, LLC, located in West Provo, Utah.



Photo Credit: Anthony Brancatelli

As a leader in community development, HUD should set the gold standard for responsible stewardship of vacant property and model the responsible disposition of property that leads to sustainable community development.

Recommendation 12: Adopt an “REO Code of Conduct.”

1. HUD should adopt a Code of Conduct for ownership and disposition of its REO property.
2. Equally important, HUD should use its status as lender, insurer, funder and regulator of community development to induce and, where possible, require private lending institutions to adopt the Code of Conduct.

Note: Pursuant to HERA, which became law on July 30, 2008, HUD no longer has regulatory responsibilities over Fannie Mae and Freddie Mac. But for this change, a third recommendation would have suggested that HUD require the GSEs to adopt the same Code of Conduct. Still, HUD’s adopting such a Code will set an important example for other agencies to follow.

As the principal agency of the federal government charged with housing and neighborhood conditions, HUD must adopt a higher standard for the properties under its control. HUD should consider incorporating the elements detailed in Addendum 4.1 into an REO Code of Conduct.

B. Looking Ahead

Recommendation 13: Address the excess supply of properties resulting from foreclosures.

Most local and state governments are ill-equipped to handle the dramatic increase in the number of vacant and abandoned properties in their jurisdictions. Existing laws and ordinances, unfortunately, are often part of the problem

rather than avenues for minimizing costs and returning property to productive use. One of the most viable and flexible options for acquiring, managing, and disposing of the excess supply of residential and commercial property is the “land bank.”

Originally proposed by an Assistant Secretary for Housing & Urban Development in 1971 as a vehicle for long term land use planning, land banking evolved over the past thirty years as a tool for metropolitan areas with declining populations to acquire abandoned tax foreclosed properties. The leading example of successful land banking today is found in Genesee County (Flint), Michigan and the Michigan Land Bank statute.

Land banking is a way for states, localities, and regions to remove properties from the market. By doing so, they mitigate the external costs of vacant and abandoned properties and stabilize neighborhoods and communities. Land banking can remove legal barriers to market-based land conversions, thereby allowing for new productive land uses or reserving land during long-term strategic planning processes. Land banking steps in when there is a failure of market conditions. It does not replace land-use planning; rather, it acquires inventory that has been abandoned and makes it available for planning.

Land banking was first recognized in federal policy in HERA, when neighborhood stabilization grants could be used to support land banking activities over a ten year period.

Over the next two years, HUD should move to assist in the development and operation of state, regional, and local banks in four ways. First, it should provide broader and deeper funding for the operational capacity of existing and new land banks. Second, it should provide discretionary grant funding (through Notice of Funds Available [NOFAs]) to state and local government entities seeking to establish land banking initiatives. Third, it should tie funding availability to inter-jurisdictional collaboration and regional planning for surplus properties. Fourth, it should tie funding availability to the reform of state and local laws (such as property tax foreclosure) that impede the return of abandoned properties to productive use.

Action Items:

1. Current and future NSP funding should expand the permissible use of funding for operational costs of land banking activities.
2. Discretionary grant funding (through NOFAs) should be available to state and local governments seeking to establish land banking initiatives.
3. Current and future NSP funding should create incentives for inter-jurisdictional collaboration.

Recommendation 14: Improve identification and access to the foreclosed property inventory.

The foreclosure crisis has revealed structural weaknesses in real estate finance and property identification systems throughout the United States. When properties go through mortgage foreclosures, the precise identity of new owners (usually the mortgagee or its affiliate) is commonly unknown as a matter of public record for months. When property ownership is uncertain or clouded, local governments and private markets are simply unable to access the property or prevent its decline and deterioration. These two structural weaknesses – the absence of foreclosure deed recording and the lack of public knowledge of foreclosed properties – should be addressed by HUD early in 2009.

Only a small percentage of jurisdictions require the recording of a foreclosure deed within a specific period of time following the foreclosure sale. To avoid public code enforcement sanctions and public pressure, foreclosure sale purchasers prefer to remain unknown or inaccessible. The solution is relatively simple and straightforward: require as a matter of state law that all foreclosure sale transfers (including deeds in lieu of foreclosure) be recorded in public records within thirty days of the sale (or judicial confirmation of the sale). HUD funding of CDBG, HOME, or NSP grants should be structured as conditional spending tied to the enactment of state laws (where they do not presently exist) mandating recordation of such deeds.

An accurate, publicly available database of all foreclosed properties does not presently exist. The creation of the Mortgage Electronic Registration Systems (MERS) in 1995 by Fannie Mae, Freddie Mac and others was a significant step in the development of a common source of identifying residential mortgages. Two-thirds of all residential mortgages are now registered with MERS. Either acting directly or in concert with Fannie Mae, Freddie Mac, and Ginnie Mae, HUD should move to broaden the MERS database to include identification of all properties transferred as a result of a foreclosure action.

Action Items:

1. Tie some portion of HUD funding to enactment of state laws mandating the recordation of foreclosure sale transfer instruments within a fixed period of time.
2. Provide funding for the creation, either through MERS or separate from MERS, of a national public database of all foreclosed properties.

Recommendation 15: Reform local and state policies.

The effects of large volumes of vacant, abandoned and foreclosed properties cannot be abated simply by the creation of land banking programs or by improvements to the structural processes of foreclosure purchaser identification and foreclosed property identification. Local and state governments need to address existing laws which themselves are impediments to returning these properties to productive use.

Local and state laws on enforcement of property taxes remain largely the product of early twentieth-century procedures. These laws create perverse incentives for owners to delay payment of property taxes for two to seven years after they are initially due, resulting in “title” that is neither marketable nor insurable in light of evolving constitutional due process standards, and frequently lead local governments to transfer delinquent tax digests to private third parties for collection.

A few states, but only a few, have undertaken comprehensive reform of property tax foreclosure laws in recent years. In these jurisdictions delinquent property tax enforcement can be completed in 18 to 24 months and provide insurable and marketable title permitting the return of the property to productive use. Reform of tax foreclosure laws also increases the initial rate of collections, a matter of increasing importance to local governments in light of declining revenues.

In parallel fashion most state and local government laws pertaining to housing and building-code violations lack efficient and effective mechanisms for enforcement. Some local and state governments have begun to adopt strong ordinances which permit “nuisance abatement” liens to have the same legal priority of encumbrance on the property as tax liens, providing a far higher rate of repayment and enforcement. Others have begun to impose monetary charges upon vacant or foreclosed properties that reflect the increased costs of neighborhoods and local governments.

HUD’s role in facilitating the reform of state and local laws dealing with property tax foreclosure and with code enforcement procedures could take a variety of forms. It could create and fund a national task force charged with development of “model” state legislation; it could provide discretionary grant funding to individual states to develop state specific legislative reforms; it could move toward “conditional spending” of existing HUD funding, tied to the enactment of appropriate state and local reforms.

Action Items:

1. Tie some portion of HUD funding for coping with REOs to the reform of state property tax foreclosure laws, resulting in the completion of procedures in 3 years from the date of tax delinquency and insurable and marketable title.
2. Providing funding for the development of model housing and building code enforcement procedures.

Recommendation 16: Change the redevelopment environment.

1. *Building strong public-private partnerships focused on specific accountabilities and outcomes.*

Investors are typically motivated to undertake the redevelopment of previously developed sites because the site has inherent attraction – such as nearby population with discretionary income or amenities in the immediate area. The strength of the market is able to cover the costs of redevelopment in a congested setting because users are willing to pay enough to cover costs, including developer profit.

In distressed urban settings, substantial additional incentives are required to stimulate investment even from motivated “urban pioneer” developers and CDCs and other mission oriented nonprofits, simply because the numbers won’t work without financial subsidy.

These financial subsidies are typically connected to provision of affordable housing for low-income or extremely low-income households in low-income neighborhoods. For example, by providing a 130 percent

housing tax credit boost in low-income census tracts – amplified by well-intentioned state policies that often reward even lower income targeting – federal policy encourages further concentrations of poverty.

While deeper affordability targeting is appropriate for high-cost areas, federal policy needs the flexibility to provide incentives for market-rate and near-market-rate development in distressed urban areas. These areas need a comprehensive and holistic application of resources and incentives to support mixed-income housing, public transportation, good schools, and green jobs based on new and retrofit technologies.

Combining current NSP, a second-generation NSP, and a revived HOPE VI-like program could provide a framework for advancing such an approach, including:

- Massive foreclosure prevention, rehab and in-fill construction to preserve neighborhoods that are sustainable but currently at-risk and under assault from the foreclosure crisis;
- HOPE VI for neighborhoods based on concepts being developed through NSP, including land banking, master planning, and comprehensive redevelopment based on metropolitan planning models, including financial incentives to regions to move toward progressive metropolitan planning models;
- Incentives to advance HOPE VI-like homeownership and rental gap funding to make up for the loss in LIHTC funding, especially for mixed-income projects in revitalization areas, and more affordable housing in higher-cost areas and suburbs.
- Modification of NSP time frames, along with commitment to future NSP-like funding, to provide opportunities for more strategic redevelopment, rather than a one-shot rush to commit funds to beat an arbitrary deadline.

In addition, federal and state historic tax credits are a key tool to help investors maximize the architectural and urban planning assets of our older communities – especially for small urban pioneer developers who, thanks to their intimate knowledge of these micro-markets, are the “first in” to these areas. The policy agenda recommended by the National Trust for Historic Preservation would support these efforts, including:

- Increasing the historic tax credit from 20 percent to 40 percent for smaller projects in which the qualified rehabilitation expenditures do not exceed \$2 million. This would target the incentive to those “main street” type developments where tax credit costs are currently too prohibitive.
- Making the 10 percent portion of the historic tax credit available for housing in all eligible buildings 50 years old or older and specifically in HUD “Difficult to Develop Areas” and Census Bureau “Qualified Census Tracts” where investment is most difficult.
- Advantaging historic projects in older and smart growth communities in proximity to intermodal transportation hubs and population densities.
- Changing rules to facilitate participation by nonprofits.
- Stimulating capital investment through recapture relief, eliminating recapture resulting from foreclosure for a three year period to encourage investment in properties located in some of America's hardest-hit markets where there is currently a severe lack of credit.

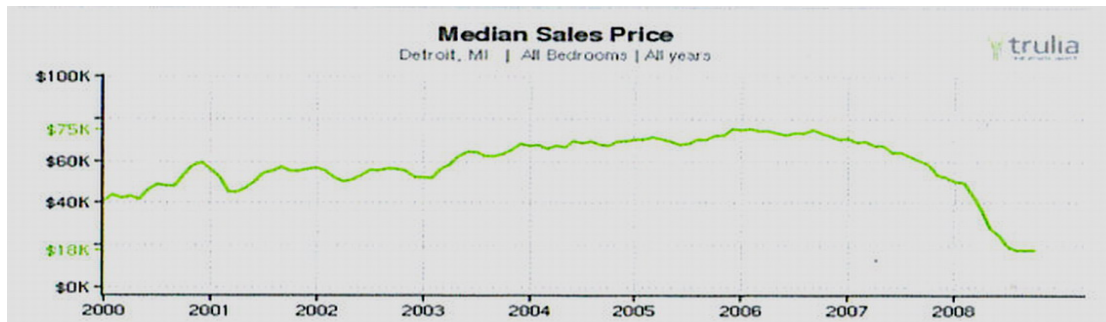
2. *Rebalancing housing supply and demand in distressed neighborhoods; that is, measurably reduce inventory of abandoned homes while increasing consumer demand for area housing.*

The challenges faced by our cities and neighborhoods vary with the wide range of conditions that characterize their housing and commercial markets. Some cities are vibrant centers supported by the strong foundation of a diverse and growing local economy; for these cities, providing quality affordable housing to meet the needs of extremely low-income households is the ongoing central challenge. But other cities, characterized by decades of the loss of manufacturing jobs and the exodus of more affluent households to the suburbs, face the added burden of population loss, declining property values, and the resulting ongoing disinvestment by property owners and loss of tax base.

Detroit is an example – if not the archetype – of the disinvested city. Built in the 1920s on the relatively high auto-worker incomes of that time, Detroit and other industrial cities of the industrial East and Midwest are comprised largely of single family homes – well-built but modest in their day – and now often functionally obsolete in the 21st century market. From a peak population of over 2,000,000 in the 1950, Detroit’s

population now stands at a little over 800,000 – predominately African-American and low-income – left to support urban infrastructure designed and built a half-century ago for more than twice as many households.⁴⁵

The result is a patchwork of low-value homes, vacant lots (often 30-40 feet wide), tax-reverted and foreclosed properties under individual, municipal, county or state ownership—creating a range of daunting problems from maintenance to land assembly to redevelopment, which these municipal governments are ill-equipped to handle. The result: increasing blight, deteriorating streets and other infrastructure, and a loss of confidence by



leading to further loss in value. In 2008 alone, the average sale price of a Detroit home dropped to \$18,513, from \$40,011 the previous year.⁴⁶

It is arguable that these cities require federal intervention no less than hurricane-ravaged metropolitan areas of the gulf coast; a population loss of more than 50 percent, they argue, is no less a disaster for having occurred over a period of decades, rather than overnight.

Remediation of this situation will take time and resources, but the strategies are clear: reduce the supply of housing and other structures – and the blight resulting from this oversupply – and create attractive environments and incentives to invest in the redevelopment of underutilized vacant land. Strategies include:

- Demolishing excess housing and other obsolete structures.
- Federal funding for land-use planning (with shrinking urban infrastructure as a mandated goal), relocating residents where necessary, and re-greening areas. These decisions are politically difficult for cities, but federal funding could create a needed incentive.
- Reconfiguring land use. Depending on the scale, vacant land could be put to uses ranging from parks to urban agriculture. By reassembling vacant land into attractive green space near existing redevelopment anchors, it could provide an amenity for the development of housing which would be relatively affordable to develop (with the abundance of vacant land), but potentially attractive to a range of incomes, to increase urban income diversity.
- Providing technical assistance/capacity building for cities. The capacity of local government agencies in acquisition, rehab, land banking and land-use planning has been eroding as a result of dwindling resources over decades. Many CDCs and other nonprofits are losing capacity as a result of closings and layoffs in the face of the current housing slowdown.

CONCLUSION

The recommendations included in this report are not intended to be an exhaustive agenda for the new administration, but rather a starting point for what will be a challenging period at HUD and for the federal government.

What we offer is a set of recommendations, some of which are immediate steps which can be implemented administratively and some of which are more fundamental changes which will obviously require a great deal more effort. It seems clear that while all the answers to this crisis are not to be found at HUD or even in the federal

⁴⁵ The cities of San Francisco, Boston, and the Borough of Manhattan, with a combined population of over 3,000,000, could be placed inside Detroit without overlapping, with over 30 square miles to spare.

⁴⁶ Detroit Board of Realtors, as reported in the *Lansing State Journal*, December 21, 2008.

government, the role that HUD can play in encouraging change at other levels of government – at the state, city, and metropolitan level – has not been fully realized in the recent history of the department.

ADDENDUM 4.1

CODE OF CONDUCT FOR OWNERSHIP AND DISPOSITION OF REAL ESTATE OWNED (REO) PROPERTY

A. Property Maintenance

HUD will:

- Not invoke its governmental immunity but instead will submit to local jurisdiction authority over housing and building codes and comply with *local* regulations regarding maintenance of properties, rather than the U.S. Department of Housing and Urban Development (HUD) standards, which may be lower.
- Appear in Court when required.
- Upon taking title, establish a finite timetable (e.g. 120 days) for either bringing a property up to code, disposing of it to a beneficial owner who will bring it up to code, or razing it where renovation is not feasible.
- Upon condemnation and order of demolition by local authorities, promptly demolish or pay the local authorities to do so.
- Maintain vacant properties secure and boarded. However, honor local ordinances if they call for no boarding or a different method of securing the property.
- Eliminate the policy of having one key that opens all HUD houses, since it has led to widespread theft and vandalism. Utilize lock boxes with many key codes.
- Pay property taxes when they are due, as other property owners are required to do so.
- HUD's sub-contractor, National Home Management Solutions (NHMS), must be made to ensure that properties are properly listed on their online listings. [These two sentences – however just in and of themselves – could possibly be omitted from the actual Code of Conduct]
- Maintain a complete on-line listing of REO inventory properties and a contact person for each. This database should be accessible to the public to ensure transparency.
- Provide local municipalities and community development organizations with a point of contact that has authority to make decisions regarding repair and maintenance.

B. Property Disposition

HUD will:

- When taking title at Sheriff's Sale, promptly cause the Sheriff's deed to be filed with the local Recorder of Deeds.
- Establish a finite period of time (e.g. 120 days) within which to transfer the properties they own to a beneficial owner.
- Provide lists of REO property to local municipalities, public Land Banks and/or community development organizations on a regular basis.
- Prior to listing with a Realtor, give a 30-day first option to municipalities, public Land Banks and/or community development organizations.
- When municipalities, public Land Banks and/or community development organizations demonstrate the intent to invest in substantial renovation, adjust prices downward so that proposed development costs, plus acquisition costs, do not exceed the amount that can be recovered by resale. HUD will discontinue the practice of seeking "top dollar" prices that in reality can only be paid by irresponsible flippers with no intent to improve the property.
- Identify purchasers who do not intend to occupy the property personally and ask local municipal authorities to screen them for experience in rehabilitation, number of properties owned, the condition of those properties, etc.

- Make no sales of multiple properties unless the proposed purchaser has been vetted and approved by local municipality authorities.
- Notify local authorities of all REO transfers.
- Comply with local Vacant Property Registration and Point of Sale Ordinances.

CHAPTER 5

STRENGTHENING AMERICA'S NEIGHBORHOODS

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

INTRODUCTION

While the 1990s and the first part of this decade have seen many American cities become stronger, more attractive, and economically vibrant, as the Brookings Institution and others have reported, some significant group of cities did not share in the improvement as robustly. One element of a strong, healthy city is whether it has “neighborhoods of choice” – neighborhoods that are safe, have housing values that generally appreciate, have good schools, and are generally good places to live. Much of the recent neighborhood improvement has occurred in cities through market forces – as more people are committed to staying in their neighborhoods and others are attracted to living in cities, people rehabilitate homes and commit themselves to a place by investing time and energy to improve the neighborhood.

In many cities, a small industry-like partnership that works on the improvement of neighborhoods has developed. Often this partnership consists of neighborhood-based improvement groups (some of which are community development corporations [CDCs], local governments, foundations, private for-profit developers, and lending institutions).

Remarkably, these partnerships and the innovations in neighborhood recovery they have developed have occurred largely without federal support. As a result, these improvements have been of significantly smaller scale and impact than they might otherwise have been if the federal government had been a consequential partner. In today's economic crisis, these partnerships are struggling to maintain themselves, and federal investment of the right kind in local innovation and a federal role in sharing best practices would be a major boost to local efforts to continue to improve neighborhoods. Put simply, HUD needs to get back in the business of neighborhood improvement.

Cities have experimented with a variety of approaches to neighborhood preservation and improvement, among them targeted neighborhood investment, inclusionary zoning, land banking, and tax incentives for development. Because local and metropolitan conditions differ so markedly, a one-size-fits-all solution to the challenges of neighborhood preservation and improvement is impossible. Instead, federal support and technical assistance to enable communities to employ the approaches best suited to their conditions and to ensure that this assistance is accompanied by accountability for results will have the greatest impact and ensure that federal monies are well-spent. This approach is also consistent with the Obama campaign's emphasis on innovation and bottoms-up solutions.

This task force recommends that the Secretary seek to significantly increase the funding for the Community Development Block Grant Program (CDBG) and revise the program's regulations so that local governments can use the funds more flexibly for neighborhood improvement, based on a community's specific needs. In addition, to promote innovation and experimentation in American cities, we recommend that the Secretary administer a special CDBG allocation of \$1 billion annually to promote innovation aimed at improving neighborhoods and, in doing so, strengthening the competitiveness of American cities.

BACKGROUND STATEMENT

The past two decades have seen growing disparities among American cities and, within all cities, among their neighborhoods. Some cities, such as New York City, Chicago, and Portland, have prospered and have witnessed significant increases in population and investment. Other cities like Cleveland, Pittsburgh, St. Louis, and Kansas City have continued to lose people and jobs. In a third group are cities such as Philadelphia and Baltimore which have seen limited revival with large parts of those cities remaining in distress. Even in the most distressed cities, however, some neighborhoods have shown renewed vitality. Any involvement in neighborhood improvement by HUD must take into account this diversity, recognize that there is a continuum of neighborhood typologies and markets, and support strategies suited to various neighborhood conditions. HUD can best accomplish the goal of revitalized neighborhoods by incentivizing and supporting carefully designed local efforts and facilitating the dissemination of best practices among local governments and stakeholders.

Over the past decade, the distinction between “strong-market” and “weak-market” U.S. cities has become clearer to policy makers and those who invest in cities. Indeed, it is clear that cities fall along a continuum from weakness to strength. Some cities, Philadelphia for example, have characteristics of both strong- and weak-market cities, and within all cities there are stronger and weaker areas. While this distinction may be less useful in the economically challenging times ahead, it is critical to recognize the diversity of market conditions in designing new federal policy and program approaches to neighborhoods.

After a period during which most American center cities were in decline due to deindustrialization and seen as a central “problem” in American political and policy debates, over the past 10 to 15 years some cities have emerged very strongly, with the following characteristics:

1. Growing service and information economies, with concentrations in finance, insurance, real estate, new media, technology, law, communications;
2. Immigration (either growth through immigration, as in NYC, or at least reduced population decline);
3. Gentrification (a mixed blessing for neighborhoods, as it sometimes leads to displacement of lower-income residents); and
4. Rising real estate values, affecting both rents and sales prices, well beyond what was projected in the 1980s.

These changes were very good ones for the cities where they occurred, bringing new economic activity, a stronger tax base, entrepreneurship and innovation, and significant real estate investment. At the same time, when the improvement was strong enough, for example, in San Francisco, Seattle, and Boston, these cities had to cope with some of the negative effects of rising prices and hot real estate markets. The issue in these places is not how to stimulate recovery – it’s happening – but rather how to use new prosperity to improve the lives and well-being of lower income households.

Essentially these problems/opportunities fall into two categories. Research by Manuel Pastor and others indicates that cities that do best economically are those cities where the gap between the rich and poor is narrow because low-income people are able to share in the city’s prosperity and move into middle-income status. In these strong-market places the most suitable public policy for neighborhoods appears to be to ameliorate the effects of market forces. This requires protecting the interests of low-income people through efforts to preserve and grow affordable housing so that lower-income residents are not forced to leave their neighborhoods or the city because of rising prices.

Many other cities continue to struggle with decline and deterioration. These cities may have seen some downtown revival and the gentrification of a few neighborhoods with distinctive locational or architectural assets. But regional economic constraints, coupled with limited resources and continued suburban sprawl, have resulted in widespread disinvestment in these places, a problem that has become even worse as the foreclosure crisis destabilizes once-vital neighborhoods. These cities’ “weak-market” neighborhoods provide much of the housing for the region’s working-class and struggling middle-class households, including large numbers of immigrants and people of color. Furthermore, in the current crisis, other more stable neighborhoods, many of which appeared to improve during recent years, are at risk of falling into a similar state. Foreclosures have had a devastating impact on many of these neighborhoods, which saw many purchases in recent years by striving home buyers seeking to realize the American dream. As both existing home owners and prospective buyers lose confidence in these neighborhoods and abandoned properties crop up on block after block, these neighborhoods are already becoming destabilized and risk collapse. A separate task force has reported on these foreclosure-impacted neighborhoods.

Although local partnerships have worked valiantly to revitalize or preserve these neighborhoods, cities and states lack the resources to address the threats they now face. The only likely alternative to an expanded federal role to address weak-market neighborhoods is the status quo.

A third category consists of distressed urban neighborhoods that contain the most problematic physical, economic, and social conditions. These neighborhoods have a deteriorated physical infrastructure, with large numbers of residential and industrial properties vacant and abandoned, as well as a visibly compromised public realm. They offer little economic activity or opportunity, with large numbers of their residents holding only low-wage employment or outside the labor force, as well as elevated levels of health problems and crime. Despite past federal efforts and continued work at the local level, these areas present deeply rooted problems that can only be tackled by very expensive, large-scale interventions.

The federal government has tried to improve urban neighborhoods over the years but has never had a coherent policy toward neighborhood growth, stabilization, or revitalization. Model Cities and Community Action Programs are too old to be relevant models for today's neighborhoods, while programs such as the Empowerment Zone and Homeownership Zone made brief appearances only to quickly disappear. The longest and most important federal program that can be used to address neighborhood improvement is the Community Development Block Grant program. However, this program has increasingly become little more than a means of spreading a diminishing resource thinly across an ever-increasing number of recipients around each city and is, furthermore, constrained as a neighborhood improvement tool by its emphasis on low- and moderate-income benefits and affordable housing. While the new Neighborhood Stabilization Program represents a well-intentioned effort to help localities grapple with the destabilizing effects of massive foreclosures, it is too new to assess its ongoing value as a neighborhood-improvement tool.

What is needed to strengthen neighborhoods in a range of market conditions is strong partnership and investment from the federal government, with HUD as the leader of this effort. HUD should be deeply involved in assisting local efforts to improve neighborhoods through the dissemination of best practices and, most importantly, the provision of significant financial resources to improve neighborhoods based on the success that is occurring in many cities. Of course, healthy neighborhoods require good schools, quality health care, and other social services, as President Obama indicated by his support of Promise Neighborhoods during the campaign. For this reason, other federal agencies, coordinated through the White House Office of Urban Policy, must also play an increased role in policy development and implementation in some locations.

STRATEGY SUMMARY

To promote strong neighborhoods in American cities across the country, we recommend HUD direct resources and expertise, through a more flexibly administered CDBG and other sources, to cities to support neighborhood improvement. These resources must be tailored to fit local neighborhood conditions. The strategies need to be different in “strong-market” neighborhoods and “weak-market” neighborhoods, but both can be assisted with targeted support that rewards innovation and allows cities the flexibility necessary to deal with their individual problems while ensuring that cities are accountable for results. To accomplish this goal, we recommend:

- Reforming the CDBG program to allow funding for neighborhood improvement based on market conditions in the neighborhoods. The use of CDBG funds should be based on the premise that it is equally valid public policy to attract middle-income people to weak neighborhoods as it is to protect the interests of low-income people via more affordable housing in strong-market neighborhoods;
- Providing research and technical assistance to promote these best practices;
- Creating a special fund (we recommend a \$1 billion annual appropriation) for use by the HUD Secretary to spur local innovation.

Addendum 5.1 to this report offers some thoughts about recent strategies to ameliorate conditions in distressed areas that the Secretary should consider.

UNDERLYING PRINCIPLES FOR STRENGTHENING AMERICA'S NEIGHBORHOODS

If the federal government is to play a useful role in preserving and stabilizing neighborhoods in weak-market communities as well as in promoting equitable development in strong markets, it should do so on the basis of a coherent strategy based on clear principles. HUD should require local governments to use these principles in crafting their development plans, and HUD should provide funds through competitive grants to cities that pursue best practices. We suggest the following principles as the framework for a federal neighborhoods strategy:

Principle 1: Develop a range of strategies that reflect the wide variation in neighborhood market conditions.

Different strategies are needed for different neighborhood market conditions. Although those conditions fall into innumerable points along a continuum, they also fall into broad categories: (1) healthy neighborhoods that are at risk of destabilization; (2) those areas that have been destabilized while retaining the physical, economic and social fabric that can lead to market recovery; and (3) those areas where destabilization and deterioration have progressed to such an extent that more transformative strategies – or long-term land banking – will be necessary before market vitality can be restored. Each category requires a different improvement strategy and HUD should equip cities to carefully investigate and fully understand their neighborhood conditions before they decide how to spend their scarce resources. In recognition of this diversity, the federal government will need to provide flexible funding and foster innovation to deal with these diverse conditions.

Principle 2: Recognize the central role of housing markets in building vital, healthy neighborhoods, and ground strategies firmly in market building and market stabilization.

Building and maintaining strong housing markets is critical to neighborhood stabilization. Market-based approaches are rooted in the assumption that functioning private markets are critical to ensuring that weak-market cities are able to create more neighborhoods of choice. While development of affordable housing in these cities continues to be an important activity to house people who cannot afford housing in the private market, neighborhood strengthening strategies need to use public resources to establish conditions that will create or increase private investment. Typically, approaches designed to strengthen markets build from strength or assets, assuming that these neighborhood anchors will help to stabilize and serve as an incentive for private development. These neighborhood market-building and recovery approaches need to have as their goal the retention and attraction of households with a mix of incomes, so that the measure of success in use of federal funds is not benefit to low- and moderate-income people, but improvements in neighborhood market conditions.

Principle 3: Promote equitable development in areas of market strength.

Equitable development connects the quest for full economic and racial participation to local, metropolitan, and regional planning and development. It is grounded in four axioms: (1) the integration of people and place strategies so that as places improve the people in the places share in the benefits of the improvements; (2) reduction of local and regional disparities; (3) promotion of "double bottom line" investments; and (4) inclusion of meaningful community voice, participation, and leadership. While the core public-policy challenge in weak-market places is to encourage private investment that would otherwise not occur, the core policy challenge of equitable development in strong-market cities is to insure that market-led (though often publicly subsidized) development genuinely shares its benefits across a broad spectrum. This principle is entirely consistent with recent research that indicates that cities with narrow ranges between haves and have-nots do better economically than cities with wide gaps.

Principle 4: Support the preservation and development of middle-income neighborhoods.

For much of its history, HUD has been an agency responsible for intervening in poor urban neighborhoods. However, cities and inner-ring suburbs cannot survive without strong and vibrant middle-class communities. These communities provide the economic vitality and social capital necessary to bring people out of poverty, and they contribute the resources cities need to provide services. HUD should explicitly recognize the importance of middle-income neighborhoods to urban vitality and should support local efforts to preserve and expand such areas.

Principle 5: Target resources to maximize potential stabilization and revitalization.

The incremental market demand that can be drawn into the neighborhoods of cities in regions with little or no overall growth – even with the best public sector strategies – is unlikely to be enough to permit the simultaneous revitalization or stabilization of more than a modest share of the city's total neighborhoods. While targeting resources

to a limited number of neighborhoods at any point is politically difficult, failure to do so all but guarantees that resources will be thrown away without lasting results. Revitalization policies should build on strengths, rather than necessarily attempting to tackle the hardest, most expensive problems first, and cities should be encouraged to make such choices. Much has been learned over the past ten years about matching public interventions with neighborhood conditions, through work by The Reinvestment Fund and the Urban Institute's Neighborhood Indicators Project. HUD could play a very important role in requiring targeting of HUD funds for neighborhood improvement and providing technical assistance to cities in making the best targeting decisions.

Principle 6: Use leverage to maximize public sector resources.

Revitalization strategies can only succeed and achieve scale when they are able to attract private resources. In the present economic environment of bank consolidation and lack of credit, every public and philanthropic dollar must be used effectively through leverage of private dollars. Successful initiatives like the Community Reinvestment Act – which drives private capital to areas housing low and moderate income people, Low Income Housing Tax Credits and New Markets Tax Credits as well as traditional lending to revitalization development – must be preserved and expanded to leverage public resources. The federal government, as a result of its much expanded role as regulator, lender, and investor in financial institutions, has a very strong role to play in directing the engagement of financial institutions in revitalization. HUD should seek out partnerships with Treasury, Federal Reserve and Federal Home Loan Banks, and other federal agencies that are regulating financial institutions and providing them with capital to encourage, if not require, revitalization financing strategies and commitments. HUD should also provide training to local officials on how to leverage public, private, and philanthropic dollars; this effort could be modeled after the successful HUD training program in the 1980s known as the Community Rehabilitation Training Center, which taught many local officials financial leveraging techniques.

Principle 7: Build human capital and economic opportunity for neighborhood residents as well as improving place-based physical conditions.

The needs of people cannot be separated from the needs of places. If lower-income residents of distressed communities are to benefit from revitalization, strategies must be put in place to build their human capital through education and workforce development, including economic development strategies aimed at creating job opportunities – or improving their access to job opportunities elsewhere. Strategies that focus on a physical development, bricks-and-mortar approach to neighborhood revitalization dominate efforts to deal with the problems of urban deterioration and decay. There is increased recognition that although a decent physical environment is important, it is not enough. Many low income families are in need of social, health, and employment services as well. Such services are critical if families are to be members of a community with the commitment and capacity to stabilize and maintain their neighborhood to ensure a quality environment in which to live and raise a family. There is growing recognition that job creation, employment training, family support, child care, youth programs, education reform, recreation, housing, crime prevention and control, and primary health care are all critical elements of community revitalization that are best addressed in an integrated manner. HUD should work closely with other federal agencies to encourage coordination of people-oriented programs in selected places.

Principle 8: Preserve or create economic diversity in revitalized and stabilized neighborhoods.

The potential for conflict between market-based revitalization and the interests of the existing lower-income residents is an ever-present reality and must be recognized. Any neighborhood strategy must explicitly take into account the interests of lower-income residents and put in place measures that enable them to benefit from revitalization and that ensure that revitalized neighborhoods provide for a diverse economic mix. HUD should play an active role in promoting community land trusts and forms of shared appreciation mortgages that result in longer-term affordability of housing in neighborhoods that are experiencing upward shifts in housing prices and rents.

Principle 9: Implement multifaceted, data-driven strategies based on neighborhood plans.

Neighborhoods are more than bricks and mortar, and stable, healthy neighborhoods are more than the sum of their sound housing units. Neighborhood stabilization strategies need to be grounded in an overall plan or strategy that focuses on the entire neighborhood, leveraging a variety of resources to address critical issues such as open space, schools (both the physical facilities and the quality of education), Main Streets, and public transportation access to employment centers. In the end, those facilities and services will have as great an impact on market strength as housing quality.

Principle 10: Create partnerships based on reciprocal obligations and responsibilities between federal government, local government, and key private and non-profit stakeholders.

If neighborhood revitalization in America's older industrial cities is to succeed, it is not enough that local governments take the federal government's money and use it in ways that meet the legal requirements of the program. Local governments must make tough, often politically difficult choices to target resources and invest in the future as well as build the local capacity to execute the complex strategies that neighborhood change demands. Future federal programs must demand that local governments make those choices, while providing local governments with tangible incentives to do so. In addition, it is important to recognize that many laws and policies that shape neighborhood development, such as zoning and tax rules, are made at the state level. States must be full partners in the effort to direct resources to support local innovation and to remove the barriers that make such innovation difficult.

FEDERAL POLICY INITIATIVES

The following proposed federal initiatives are intended to serve as the building blocks for a HUD strategy to partner with local governments to assist in revitalizing and stabilizing neighborhoods in the three categories of market conditions described earlier. In order to play its appropriate role as a full partner in neighborhood development, HUD should direct its resources, through expanded and targeted CDBG allocations, to incentivize innovation at the local level.

A. HUD should make a long-term commitment to neighborhood stabilization

Rebuilding neighborhood markets is a long-term venture. Distressed neighborhoods in weak-market cities are the product of decades of disinvestment. The devastation that defaults, foreclosures, and abandonment have wreaked in America's struggling neighborhoods will take many years to reverse and will require resources far beyond the means of state and local governments or local philanthropic institutions. An ongoing, rather than "one-shot" approach to neighborhood stabilization is needed at the federal level, supported by an annual appropriation. Federal programs, CDBG and others, should be based on the principles outlined above and targeted toward neighborhoods that are destabilized – or at imminent risk – but which also have the assets to make market recovery realistic.

CDBG and other federal grants, while principally funding "bricks and mortar," should provide the flexibility needed by local actors to use funds for other place-based purposes, including foreclosure prevention, targeted code enforcement and other key elements in a neighborhood strategy – including parks, schools, and transportation – designed to maximize leveraging of state and local, as well as private sector, resources. The HUD Secretary should direct the Assistant Secretary for Community Planning and Development and other staff to review all rules and regulations to ensure that they are in line with the principles of neighborhood revitalization, and should propose changes to the statute where necessary. For example, HUD should allow recipients broader latitude in the use of funds to stabilize neighborhoods that are in earlier stages of decline. Since CDBG funds are generally limited to providing assistance to households whose incomes are below 80% of median, it is often difficult to use funds in lower middle-class neighborhoods. Relaxing this income requirement in circumstances when the municipality can show a positive impact in strengthening neighborhoods would provide much needed flexibility, especially in older cities.

Recommendation 1: Support neighborhood homeownership through tax incentives.

Neighborhood revitalization and market building are inextricably linked. Tools designed to motivate prospective homebuyers to purchase homes in target areas are a critical complement to the implementation of an effective neighborhood strategy. Areas in need of revival, particularly in weak-market environments, are likely to be those in which market demand has declined along with consumer confidence in the future of the area. In such areas, prospective buyers have little expectation of future appreciation and fear of continued depreciation. In many locations, house prices have often fallen below replacement-cost levels, and the cost to acquire a property in need of significant work and restore it for owner-occupancy exceeds the resulting market value of the property. In other words, a prospective buyer's economic calculus works against buying a house in the area and doubly against buying a house in need of rehabilitation. HUD programs should enable local governments to craft programs that will produce economically integrated and sustainable communities and should incentivize, through competitive grants, local efforts to build on neighborhood strengths and attract new residents. In addition to these steps, the federal government

could offer a targeted, income tax credit for individuals purchasing and rehabilitating homes for owner-occupancy in target neighborhood stabilization and revitalization efforts. This would encourage acquisition and rehabilitation in these areas.

Recommendation 2: Fund transformative investment: a “HOPE VI” for neighborhoods.

For the neighborhoods we have identified as those in category three – those that have been devastated by decades of disinvestment and abandonment – incremental strategies will not work. On the other hand, the resources of vacant and underutilized land – often located in proximity to valuable locational assets, such as transit stations, major public open space, or institutional anchors – create the opportunity for large-scale developments that can have a transformative effect on the area, drawing new market demand into the city. Such developments, however, require large amounts of initial capital, and – because they are based on drawing new rather than existing market demand – are difficult to finance through conventional means. The federal government could play a strong and unique role in fostering this type of transformative investment, by providing a combination of grant or subordinated loan funds, loan guarantees, and tax incentives to local governments to support developments of scale consequential enough to create market demand in these areas, much as the best of the HOPE VI projects have done in public housing settings. Projects would have to demonstrate that the market potential is realistic and local governments would have to make a strong commitment – financial and political – to the success of each of these transformative projects.

Recommendation 3: Support land banking and green infrastructure.

Where market demand is inadequate to absorb the available housing in a city, as it is in some of the cities in the Midwestern Rustbelt, the market for housing in the most distressed neighborhoods has effectively disappeared. Even with livable houses offered for \$20,000 or less, properties find few takers and more and more houses are abandoned. In these areas – sometimes a third the land area of the city – the most rational strategy is to bank the land for the long-term, releasing it selectively for redevelopment or revitalization, while fostering a variety of both interim and permanent green uses – including gardens, forests and urban agriculture – that help build a more sustainable city. As the experience of the Genesee County Land Bank in Flint, Michigan has shown, such programs can be largely self-sustaining, helping to stabilize the city and improve its quality of life, as well as create development opportunities for the future.

In areas where market conditions make it a rational strategy, the federal government should actively support such efforts through a combination of start-up financial and technical support for qualified land-bank entities, funding for demolition, tax incentives to encourage donation to land-bank entities, and financial support for urban agriculture projects tied to creation of employment opportunities and food security in their communities. Support for land bank entities should not be without conditions. It would be unwise for the federal government to provide support to local jurisdictions that fail to take action to maximize their ability to both assemble and use their land appropriately. To be eligible for federal assistance, local jurisdictions should be required to create viable land-bank entities, establish tax foreclosure procedures designed to maximize public benefit and land assembly, and adopt land stewardship and disposition practices consistent with the creation of a green infrastructure in their community.

Recommendation 4: Build local capacity.

Localities vary widely with respect to the critical organizational and human capital resources needed to both plan and execute complex neighborhood revitalization and stabilization activities. There is a wide range of expertise – from weak to strong – in city housing and community development departments, in neighborhood based groups and CDCs as well as in the foundation and lending sectors in cities. Some cities have strong, capable, real estate developers and owners, while others are contending with less scrupulous absentee landlords. However, few city governments have staff with the skills to analyze market conditions and use that analysis to frame targeted neighborhood-scale market recovery strategies. Among the many skill areas that may be relevant to carrying out such strategies are the ability to analyze neighborhood market conditions, develop effective land banks, establish targeted and systematic code enforcement and nuisance abatement programs, and create and maintain property information systems.

HUD should work directly with and through national community development intermediaries to strengthen the Section 4 program to provide a sustained long-term, program of capacity building through training and technical assistance to local governments and CDCs. In addition to funding training and technical assistance, small grants should continue to be provided to address specific capacity needs. These could include multi-year grants for operating support to a CDC or to enable a city to add critically needed personnel; they might also assist a city to set up a property information system or upgrade the technology used by its code enforcement agency.

Recommendation 5: Reform regulations and decentralize some decision making.

The most successful efforts to support neighborhood development are locally designed and driven efforts that are collaborations between public and private institutions. Often these collaborations are hindered by federal regulations narrowly tailored to specific programs. One way that HUD can support existing programs and efforts – in a short time frame and without increasing resources – is to increase the capacity in regional offices and to empower regional offices to make more decisions regarding the appropriate use of federal funds.

In addition, because most decisions are made in Washington, it is challenging at best to have those decisions take into consideration differences in city and regional markets. For example, for a regional office to authorize selling a single HUD-owned property, it must be approved in headquarters. Headquarters makes the final decisions to demolish even one unit of public housing. Empowerment of regional offices would enable HUD to better align resources and decisions with locally driven needs and programs and to respond more rapidly to changing circumstances. The opportunity exists to review the extent to which existing and newer efforts respond to local issues.

Recommendation 6: Treat urban revitalization as a greening strategy.

The HUD neighborhood strategy proposed here should be viewed as part of the federal government’s larger strategy to foster energy efficiency and combat climate change. A strategy that focuses on building market demand in areas with compact development patterns and already served by public infrastructure is inherently “greener” than alternative development strategies. The federal neighborhood strategy should incorporate a series of explicit features to maximize the environmental benefits of the strategy, including linking neighborhood revitalization to transit improvements to maximize use of public transportation and reduce auto dependency in revitalized areas; establishing standards for revitalization activities that promote walkable development patterns in revitalized areas; encouraging energy-efficient development, including retrofitting existing buildings for greater energy-efficiency and building the green infrastructure – gardens, parks, forests, urban agriculture – in each neighborhood, particularly where land availability exceeds market demand. HUD should incentivize such activities by providing additional resources to cities that undertake such efforts.

Recommendation 7: Support affordable housing through inclusionary zoning.

Several hundred cities around the country have adopted “inclusionary housing” programs, which require and/or encourage developers to make a percentage of housing units in new residential developments available to low- and moderate-income households or to provide funding to support the development of affordable housing elsewhere in the community. In return, developers receive non-monetary compensation – in the form of density bonuses, zoning variances, and/or expedited permits – that reduce construction costs. By linking the production of affordable housing to private-market development, inclusionary housing expands the supply of affordable housing while dispersing affordable units throughout a city or county to broaden opportunity and foster mixed-income communities.

Inclusionary housing approaches have been successful in cities such as Boston and San Francisco. Although zoning decisions are made at the local level, HUD should encourage inclusionary housing by promoting best practices and disseminating information to states and municipalities. While local flexibility is one of the strengths of inclusionary housing, having hundreds of different programs can be confusing for developers. HUD should assist in the development of national standards for such programs as well as provide active guidance on which program approaches are most effective in different housing market conditions. In addition, HUD should issue guidance on how inclusionary housing fits into a Consolidated Plan and regional plans, as proposed by another task force, and should encourage municipalities and regions to adopt inclusionary housing approaches. HUD should provide planning grants for inclusionary housing and similar programs. In some metropolitan areas, inclusionary housing is a controversial measure. Federal support could provide an incentive for localities to experiment with the idea.

Recommendation 8: Support inclusionary tax incentives.

Some municipalities use tax incentives to encourage new development when the market is weak. For example, Philadelphia offers a 10-year exemption for residential new construction, in order to encourage developers to build. In strong-market cities, such incentives are not necessary to encourage new development. These cities can instead offer a tax abatement or incentive for those developments that include affordable housing. Such a program can be combined with inclusionary zoning as one of the incentives a developer receives. HUD should support such efforts through technical assistance and grants to localities undertaking such efforts.

Recommendation 9: Support mixed-income development.

Many federal affordable housing programs were designed with a very specific income group in mind, and the easiest way for states and municipalities to administer them, or for developers to use them, is to build developments that are all for people of identical incomes. As a result, subsidized affordable housing production often has the unfortunate and unintended consequence of further economic segregation. HUD should support mixed-income developments by expressing a preference for such developments in CDBG, Home Investment Partnerships (HOME), and other program regulations and should also reform regulations to make it easier for local governments and developers to mix different sources of funds. Although perhaps outside of its formal legal authority, HUD should encourage the Treasury Department to restructure the Low Income Housing Tax Credit (LIHTC) program to encourage use of that program to create mixed-income communities.

Recommendation 10: Play a central role in inter-agency strategies for distressed neighborhoods.

HUD has a long history of participation in efforts, such as Model Cities and Empowerment Zones, designed to revitalize distressed neighborhoods. However, the results of such efforts have been mixed at best. Comprehensive strategies for distressed neighborhoods require the cooperation of numerous federal agencies, including the Department of Health and Human Services (HHS), the Department of Education, and the Department of Treasury. HUD, as the agency responsible for urban development, should play a critical role in any such initiatives undertaken by the administration. However, HUD should retain its primary focus in promoting housing and urban development. This principle should be applied to President Obama's commitment to Promise Neighborhoods, which has succeeded in its prototypes to improve opportunities for poor children in Harlem. HUD should play a supportive role to the White House Office on Urban Policy as this program is implemented.

A CLOSING COMMENT

HUD's understandable emphasis on stimulating the creation of public and privately owned affordable housing has interfered with an equally important mission of working in partnership with mayors, county executives and others to improve America's neighborhoods. Building HUD's capacity to be a welcome, flexible partner with those toiling at the local level to strengthen neighborhoods is needed even more now than in the past, given the startling effect the recession and foreclosure crisis is having on many neighborhoods in America. It will take rebuilding and a greater breadth in orientation by HUD, but the approach is entirely consistent with HUD's mission.

ADDENDUM 5.1

TARGETING CONCENTRATED INVESTMENTS FOR NEIGHBORHOOD REVITALIZATION: A Summary of Key Lessons Learned from the Research Literature

By George Galster

Targeting Can Work

A neighborhood revitalization strategy involving the sustained targeting of substantial public and/or non-profit investments *can* succeed in turning around even highly disinvested places. The most acclaimed (and thoroughly vetted; see Galster et al., 2006) example is Richmond, VA's "Neighborhoods in Bloom" (NiB) program, which was begun in 1998. The NiB program was targeted geographically for concentrated, sustained, highly visible interventions. Three factors seem to be responsible for its success.

First, there was a coincidence of committed leadership, competent City staff, and an effective planning process. From its inception, the Neighborhoods in Bloom program enjoyed strong leadership from the City manager and several City councilors. Within the community at-large, Local Initiatives Support Corporation (LISC) and several community development corporations (CDCs) actively supported and helped to organize the initiative. The City staff charged with organizing and implementing the NiB program has been widely regarded as competent and helpful. The City administration and Community Development Department, as well as LISC and its affiliated CDCs, actively solicited the input of affected parties to develop consensus about the need for targeting and about the neighborhoods that should be included. They used a data-driven method of prioritizing the neighborhoods so that all could understand and attest to its objectivity. As a result, City councilors and the larger public were able to support the initiative overwhelmingly.

Second, the City of Richmond created a critical mass of multiple resources and applied them strategically: \$21.33 million was invested in a concentrated fashion over five years in target areas comprising only 300 blocks. The funds and services provided by the City – Community Development Block Grant (CDBG), Home Investment Partnerships (HOME), capital improvement funds, focused code enforcement, tax-delinquent sales and property disposition priority, accelerated historic preservation review, and housing counseling – as well as funds and services provided by LISC, represented a large scale, comprehensive package of revitalization initiatives. Moreover, Richmond committed resources with substantial certainty over a multi-year period. But, even more critically, these initiatives were spatially focused so they reached threshold concentrations that stimulated private market activity and brought about perceptible changes in the target neighborhoods.

Third, Richmond had a well-functioning community development industry, anchored by the Richmond Community Development Alliance (RCDA), organized by Richmond LISC in the 1990s. The RCDA sought to ensure that CDCs expanded capacity, cooperated with each other, and spoke to the City in a coherent voice. Although Richmond's CDCs did not form until the early 1990s, by the onset of NiB they had developed good working relationships with the City, lenders, appraisers, and other private-sector partners. Thus, most of them were capable of rapidly increasing housing production levels when NiB's resources became available.

Neighborhood Reinvestment Thresholds

Targeting is crucial because the public dollars must push the neighborhood above its reinvestment threshold if private monies are to be leveraged. Several recent studies suggest that there are two spatial scales where reinvestment thresholds occur, one at the census tract level and another at the block level. Regarding the larger scale, Galster et al. (2004b) conclude that CDBG expenditures do not have a noticeable relationship with altered neighborhood trajectories unless they exceed roughly \$261,000 per census tract cumulated over three years (\$87,000 annual average). NiB findings are consistent at the census tract scale. Regarding the smaller scale, NiB observed much larger positive

impacts when a block received at least \$21 thousand site-specific and roughly \$9 thousand infrastructure investment from public and nonprofit sources, on average.

Even though the Richmond evidence suggests a relatively low block-level threshold where leveraging of added private investments becomes more significant, this should not be taken out of context. It is likely that the property investment psychology across the entire target area was under-girded by: (1) a highly visible, participatory planning process culminating in the designation of a target area (and subsequent significant site-specific investment in at least some of it) and (2) NiB-related infrastructure improvements and service enhancements across the entire NiB area. This is supportive of the notion that “building neighborhood confidence” is an important outcome that can be triggered by the symbolic spinoffs from well-publicized public investments in an area.

CHAPTER 6

NEW STRATEGIES FOR A METROPOLITAN AMERICA: EXTENDING HUD'S URBAN AND REGIONAL MISSION

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

EXECUTIVE SUMMARY

The United States is a metropolitan nation. Over 80 percent of the nation's population lives in metropolitan areas. Many of our national objectives require regional responses that take into account our metropolitan character. Yet we are not organized either at the metropolitan or the federal level to effectively pursue these objectives. The need for better regional governance within metropolitan areas has increased, but in most metropolitan areas the response has been inadequate. Federal programs and activities affecting metropolitan areas and the local governments within them are scattered among a large number of federal agencies and departments. No department has primary responsibility for the challenges and opportunities of our metropolitan regions.

The U.S. Department of Housing and Urban Development (HUD) should seize the opportunity and put itself in the forefront of a regional policy effort. HUD should explicitly re-focus its mission to encompass one of the prime goals Congress originally envisioned for it – shaping the future of our urban and metropolitan regions. HUD's programs and activities should be reshaped to reflect this goal.

The basic strategies and specific recommendations we make are set forth below.

Recommendation 1: HUD should actively and publicly embrace and affirm an urban and regional mission in addition to its housing mission.

Recommendation 1.1: HUD should revise its mission statement so that it includes the statement, “to foster decent homes and livable communities in economically strong and environmentally sustainable metropolitan regions.”

Recommendation 1.2: The HUD Secretary should request that each Assistant Secretary submit to him a report with recommendations and options for how programs and policies in his or her area could support HUD's urban and regional mission. These reports should form the basis for a HUD task force which will allow the Assistant Secretaries to collaborate about how best their programs can support the regional mission.

Recommendation 1.3: The HUD Secretary should communicate the re-framing of HUD's mission to HUD's constituencies and should consult with them to determine the most effective ways to implement the broadened mission.

Recommendation 1.4: HUD should change the title of the Assistant Secretary for Community Development to the “Assistant Secretary for Urban, Regional and Community Development” and authorize the Assistant Secretary to coordinate HUD programs that encourage regional activities and effective regional governance, including those we recommend in this report.

Recommendation 1.5: HUD should contract with a respected independent and objective non-governmental organization such as the National Research Council (NRC) of the National Academy of Sciences to prepare and publish a biennial “Report on Urban and Metropolitan Areas.”

Recommendation 2: HUD programs should support, through incentives and other means, regional activity that helps to build stronger communities and is consistent with and advances important national objectives. HUD should structure its programs, where appropriate, to pursue those objectives.

Recommendation 2.1: HUD should propose new legislation that would create a “Regional Challenge Grant,” a multi-year competitive grant program for proposals designed to have a regionally significant impact.

Recommendation 2.2: HUD should propose legislation that would modify Community Development Block Grant CDBG (and possibly the Home Investment Partnerships Program [HOME]) to provide incentives for regional activity and, at the same time, to encourage and strengthen regional governance processes. We recommend that one-third of any increase in CDBG funds should be set aside for activity devoted to regional purposes.

Recommendation 3: HUD should engage in activities to encourage and enhance effective regional governance in metropolitan areas.

Recommendation 3.1: HUD should submit legislation to provide general operating funds (“glue money”) for a designated multi-purpose planning agency in metropolitan areas.

Recommendation 3.2: HUD should provide funds for the designated regional organization to produce, or contract for the production of a periodic “State of the Region Report.”

Recommendation 4: HUD should play the lead role in efforts to develop linkages among programmatic silos that, at both the federal and regional levels, impede effective responses to the needs of metropolitan areas.

1. At the federal level

Our recommendations assume the creation of a new White House Office of Urban and Metropolitan Policy (WHOUMP or the White House Office), one of whose primary objectives will be to place the power of the Presidency behind achieving greater coordination among the urban- and regional-related programs dispersed among many federal agencies. Assuming the existence of WHOUMP, we recommend that

Recommendation 4.1: HUD, as the federal department with the most explicit urban and regional mission, should be the lead federal agency in working with WHOUMP to achieve greater coordination among these programmatic silos, including detailing staff to assist in this endeavor.

Recommendation 4.2: HUD should work with the White House Office of Urban and Metropolitan Affairs to set up an inter-agency task force to explore ways in which the urban and regional functions of the various federal agencies and departments can be more effectively coordinated.

Recommendation 4.3: In a Regional Challenge Grant program such as the one recommended above, HUD (or HUD, in conjunction with WHOUMP) should take a lead coordinating role in proposals that request resources from federal agencies in addition to HUD.

Recommendation 4.4: HUD should compile and update an inventory, for the use of both federal and state and local governments, of programs affecting urban areas throughout the federal government and how these programs relate or could relate to each other.

2. At the regional level

Recommendation 4.5: HUD should require that its Consolidated Plan be coordinated with, and, if possible prepared by, the same regional agency that produces the region’s Transportation Improvement Program (TIP).

Recommendation 4.6: HUD should work with the new White House Office and with other federal agencies to require that federal regional planning programs (such as those of the Department of Transportation [DOT], Economic Development Administration [EDA], Environmental Protection Agency [EPA], and Department of Labor [DOL], etc.) be funded through and be the responsibility of a common organization at

the regional level, i.e., the organization designated above as the multi-purpose planning agency in each metropolitan area receiving the federal “glue money” discussed above.

Recommendation 5: HUD should enhance urban and regional data collection, research, evaluation, and analysis capacity both at HUD and at the metropolitan level.

Recommendation 5.1: HUD, in conjunction with the new White House Office of Urban and Metropolitan Policy, should accept the primary role in identifying and providing the data required for understanding important urban and regional processes, challenges, and opportunities and the policies addressed to them, and for measuring and reporting progress in achieving regional performance goals.

Recommendation 5.2: HUD should identify critical gaps and shortcomings in data for urban and regional analysis and, again in conjunction with the new White House Office, establish inter-agency data standards and encourage the relevant federal agencies to collect and provide such data.

Recommendation 5.3: HUD should enhance and expand the capacity of the Office of the Assistant Secretary of Policy Development and Research for urban and regional data collection, policy analysis, performance reporting, evaluation, and research.

Recommendation 5.4: HUD should focus its research both on basic processes related to urban and regional systems and on policy concerns and policy approaches to attain national objectives. In particular, it should promote research on regional development processes and on the effects of policies designed to produce sustainable development within America’s metropolitan areas.

Recommendation 5.5: As one of only a few explicitly spatial departments in the federal government, HUD should become a central agent for the development and use of spatial statistics in order to support both its own research needs and its ability to interface with its customers through easy-to-use mapping systems.

Recommendation 5.6: HUD should become a “customer friendly” provider of data for a variety of purposes and a variety of customers.

Recommendation 5.7: HUD should make available funding for urban and regional data collection and research to the regional entity that receives federal planning “glue money” in major metropolitan areas.

INTRODUCTION AND BACKGROUND

The United States is a metropolitan nation. Over 80 percent of the nation's population lives in metropolitan areas. Metropolitan areas produced more than 90 percent of our economic output in 2005. Success in the global economy requires well-functioning regional economies. Housing and labor markets are region-wide. Transportation systems serve entire regions; pollution and environmental concerns spill widely beyond the boundaries of local jurisdictions. The American value of equal opportunity requires regions that give everyone the choice to live in affordable housing in quality communities that connect them to economic opportunities. Smart regional development that coordinates land use, transportation, and other functions is necessary to reduce greenhouse gases and protect the environment.

Many of our national objectives require regional responses that take into account our metropolitan character.

National economic competitiveness and economic recovery must be built on strong and competitive *regional* economies. Indeed, national economic growth is a composite of growth in the nation's regional economies. Since metropolitan economies are regional in nature, beggar-thy-neighbor competition among local governments within a region is a waste of resources for building a strong regional economy. And regional economic growth is a prerequisite for healthy cities and suburbs within the region.

National affordable housing objectives also require regional action to assure that "workforce housing" is available throughout the region for workers who wish to live close to their jobs. National employment objectives also require regional action. Problems of "spatial mismatch" between the location of workers and the location of jobs require effective regional transportation systems, particularly to make jobs in the suburbs accessible to lower-income workers living in core cities.

Furthermore, critical national sustainability objectives—such as reducing energy consumption, imported petroleum, and greenhouse gases—can only be accomplished by reducing vehicle-miles traveled. Accomplishing this objective requires action at the regional level, such as efforts to match jobs and housing, increase transit use through transit-oriented development, and decrease the need for automobile trips through mixed-use development.

Yet we are not organized either at the metropolitan level or at the federal level to be able to effectively pursue these objectives. The typical American metropolitan area is governed by large numbers of general-purpose local governments and special-purpose authorities (governmental fragmentation). Regional multi-purpose government institutions are notably lacking in all but a few metropolitan areas. More importantly, most metropolitan areas lack adequate regional governance capacity. "Regional governance," as distinct from "regional government," is comprised of formal and informal agreements among individual units of local government in the region as well as collaboration among the private, non-profit and foundation sectors that engage in activity with regional consequences. The need for better regional governance to supplement the existing set of local government institutions within metropolitan areas has increased, but in most metropolitan areas the response has been insufficient.

At the federal level, departments and agencies are organized by function rather than by place. Programs and activities affecting metropolitan areas and the local governments within them are scattered among a large number of federal agencies and departments. No department has primary responsibility for the challenges and opportunities of our metropolitan regions.

HUD should seize the opportunity and put itself in the forefront of a regional policy effort. Although "urban" is part of the title of the Department of Housing and Urban Development, its primary concern has historically been housing. Housing, of course, is a critical urban concern and, beyond that, HUD has been responsible for important urban programs such as the Community Development Block Grant (CDBG), the Urban Development Block Grant (UDAG), Empowerment Zones, and Model Cities. However, over most of its history HUD's urban activities have been focused on relatively small scale urban and community development, particularly housing and land development, funded through, and implemented within a single local jurisdiction. A concern for metropolitan areas and regions has been almost completely missing, despite the fact that the act that established the Department declared:

The Congress hereby declares that the general welfare and security of the nation and the health and living standards of our people require, as a matter of national purpose, sound development of the nation's communities and metropolitan areas in which the vast majority of people live and work.

To carry out such purpose... the Congress finds the establishment of an executive department is desirable... to assist the President in achieving maximum coordination of the various federal activities which have a major impact upon community, suburban, or metropolitan development; to encourage the solution of problems of housing, urban development, and mass transportation through State, county, town, village and private action, including promotion of interstate, regional, and metropolitan cooperation.

We recommend that HUD explicitly refocus its mission to encompass the important goal that Congress originally envisioned for it - shaping the future of our urban and metropolitan regions. HUD's programs and activities should be reshaped to reflect this goal. HUD should be focused on helping regions and the various local jurisdictions within them to take advantage of and build upon their opportunities and assets. Indeed, HUD's current efforts, particularly in housing but in other programs as well, will become more effective if placed in a regional context. The need for a regional approach is increasingly recognized – and was an explicit and consistent part of President Obama's campaign. HUD is perfectly positioned to fulfill this campaign promise and to increase the efficacy of federal support for urban and metropolitan economic growth.

More broadly, HUD should focus on building healthy communities throughout metropolitan regions. A place-building orientation challenges the silo-driven approach and highlights the need for a concern for metropolitan areas and regions. Healthy places require not just decent affordable housing but also access to jobs (economic development, job training, transportation), good schools (local school districts, private and parochial schools, higher education), convenient transportation (regional transportation authority), safe and secure neighborhoods (regional crime detection and threat-abatement security), and recreational opportunities (municipal, county, and regional parks departments). HUD's new mission of promoting healthy regions will give it a central role in coordinating efforts across governmental functions. By shifting its focus to building places, HUD will also broaden its focus from one concerned primarily with problems (housing affordability, poverty, etc.) to opportunities and assets. Our metropolitan regions are filled with underutilized assets; genuine economic recovery requires that we invest wisely in people and places in order to create wealth and inclusive prosperity.

STRATEGIC PREMISES

HUD is the logical federal agency to take the initiative in addressing urban and metropolitan areas in a holistic manner. The strategic premises that underlie our objectives and recommendations for HUD as it expands its mission are as follows.

- Metropolitan regions are the key spatial units of the American economic and social system. The national economy is comprised almost completely of metropolitan area economies.
- Important national objectives related to economic growth, housing, jobs, transportation, environment, energy, and climate control cannot be accomplished without effective action at the regional level.
- Within metropolitan areas, more effective regional governance is necessary to address the most important economic and social challenges facing these areas and to take advantage of assets and opportunities that exist within the region.
- The core cities of metropolitan areas have been the centers of innovation, opportunity, and productivity that have driven national economic competitiveness and growth. The people who live in these cities represent enormous real and potential human capital assets. And the core cities of our metropolitan areas remain critical for our national economic success. Yet, many of the challenges now facing these cities can only be met within a regional context. There are very few examples of strong, well-functioning cities in economically weak metropolitan areas. A regional approach does not mean abandoning concern for cities; instead, it means addressing city concerns more effectively through regional action.
- Furthermore, significant problems exist outside central cities. In inner-ring suburbs governmental capacity is frequently not adequate to address the challenges facing them. Likewise, sprawl at the outer margins and uncoordinated development throughout metro areas have produced land-use patterns that exacerbate problems, such as traffic congestion and air pollution.

- The current institutional structure in most metropolitan areas is inadequate to allow the local governments within the area to effectively address problems that affect them but transcend their borders. Regional governance mechanisms must be strengthened in order to empower local governments to act in their interests at the regional level.
- While the local government structure of metropolitan areas is a state government concern, the federal government – and HUD in particular – should encourage regional approaches by providing incentives and resources for regional planning and capacity building and by organizing federal programs so that stove-pipes are broken down (or bridges built to connect them) at both the federal and local levels.
- The objective of federal strategy is not to build a regional government to replace local governments or to design a model system of regional planning or governance. The objective is to help to facilitate improved systems of regional governance within metropolitan areas so that state government, local government, foundations, and private and non-profit actors working together at the regional level will be able to take advantage of metropolitan area assets and opportunities.
- HUD’s mission gives it the lead role among federal departments in urban and metropolitan concerns. However, as one department among many departments and agencies, HUD cannot, acting on its own, play an effective role as the lead department without White House support.
- Therefore, our recommendations assume that there will be a White House Office of Urban and Metropolitan Policy that will play the lead role, with HUD’s assistance, in organizing policies at the federal level that affect urban and metropolitan areas.

A. Recommended Objectives and Strategy Summary

Recommendation 1: HUD should actively and publicly embrace and affirm an urban and regional mission in addition to its housing mission.

Recommendation 2: HUD programs should support, through incentives and other means, regional activity that helps to build stronger communities and is consistent with and advances important national objectives. It should structure its programs, where appropriate, to pursue those objectives.

Recommendation 3: HUD should help to bring about effective regional governance in metropolitan areas.

Recommendation 4: HUD should play the lead role in efforts to break down (or provide bridges across) programmatic silos that, at both the federal and regional levels, impede effective responses to metropolitan area needs.

Recommendation 5: HUD should enhance urban and regional data collection, research, evaluation, and analysis capacity both at HUD and at the metropolitan level.

B. Specific Recommendations:

Recommendation 1: HUD should actively and publicly embrace and affirm an urban and metropolitan mission in addition to its housing mission.

Although “Urban” is part of the name of the Department of Housing and Urban Development, and although it has been responsible for important urban programs (it played a role in assisting the development of regional planning and regional institutions during the 1960s and 1970s), it is fair to say that its primary focus throughout its history has been housing. The historic focus on housing is not surprising. HUD emerged from the Housing and Home Finance Agency (HHFA). If one looks at its website, HUD’s mission as currently stated is “to increase homeownership, support community development, and increase access to affordable housing free from discrimination.” If one inspects HUD’s organization chart, none of the major units or sub-units contains the words “urban,” “metropolitan,” or “regional.” The closest a major organizational box comes to any of these broad place-based terms is the “Assistant Secretary for Community Planning and Development.”

Obviously housing has been and, particularly now, remains a major national concern, and our recommendation that HUD extend its mission is not intended to detract from the centrality of housing as a component of HUD's mission. But a focus upon housing need not be set against a broader concern for the health of America's urban and metropolitan areas, particularly since there are no other units of the federal government (including Congress as well as the Executive Branch) where such a concern is located.

How can HUD take on a leading role in shaping America's cities and metropolitan areas? We urge that it explicitly signal its intention to do so and announce that it intends to become the institutional urban and metropolitan conscience for the nation. We recommend the following.

Recommendation 1.1: HUD should revise its mission statement so that it includes the statement, "to foster decent homes and livable communities in economically strong and environmentally sustainable metropolitan regions."

Recommendation 1.2: HUD should change the title of the Assistant Secretary for Community Development to the "Assistant Secretary for Urban, Regional and Community Development" and authorize the Assistant Secretary to play a role coordinating the HUD programs and activities that encourage regional activities and effective regional governance, including those we recommend in this report.

Recommendation 1.3: HUD should also be responsible for contracting with a respected independent and objective non-governmental organization such as the National Research Council (NRC) of the National Academy of Sciences to prepare and publish a biennial report on Urban and Metropolitan Areas. The report should set forth and assess conditions, trends, problems, and opportunities of both metropolitan areas and their core cities. It should be analytical and synthetic in nature and should identify key trends that will require HUD's attention in the future. HUD should request that the authors of this report provide feedback to it on the new data requirements and data enhancements for HUD that we recommend in Recommendation 5 of this report.

From 1970-2000 HUD took the lead in preparing the President's *National Urban Policy Report* and later the *State of the Cities Report*. While very useful, these reports were too often viewed as justifications and rationalizations for the incumbent administration's policies and actions or inactions, often reflecting the point of view of the political side of the White House. An independent report upon which HUD might be asked to provide comments about Administration policy would be more trusted and more useful.

Recommendation 1.4: The Secretary should request that each Assistant Secretary submit to him a report with recommendations and options regarding how programs and policies in his or her area could support HUD's urban and regional mission.

Recommendation 1.5: To assure that the Secretary's inclusion of an expanded urban and regional mission spreads throughout the organization and to promote continuing attention to the regional agenda, the Secretary should keep leadership at the Secretarial level by constituting a HUD regionalism working group, composed of relevant HUD appointees and staff, to assist the Secretary in further development and implementation of HUD's urban and regional agenda.

Recommendation 1.6: The HUD Secretary should, at the earliest possible moment, communicate the re-framing of HUD's mission to HUD's constituencies and should consult with them to determine the most effective ways to implement the broadened mission. He should conduct regular outreach, consultation, listening, and deliberation processes with key constituencies and potential constituencies for this regionalism agenda.

Recommendation 1.7: The HUD Secretary should, upon the creation of the new White House Office of Urban and Metropolitan Policy, announce that he considers WHOUMP an indication of the President's commitment to metropolitan areas and their local governments and that he will cooperate and work closely with that office to the maximum extent possible.

Recommendation 2: HUD programs should support, through incentives and other means, regional activity that helps to build stronger communities and is consistent with and advances important national objectives. It should structure its programs, where appropriate, to pursue those objectives.

Metropolitan regions are the units in which most people conduct their lives. People seek employment throughout the region. They search for housing throughout the region. They frequently commute to work from their home in one local government to their work in another. They shop throughout the region and engage in recreation, entertainment, and culture region-wide. Businesses search for locations throughout the region and employ workers who live throughout the region. Transportation systems must be planned and operated regionally in order to meet these needs. Pollution spills over from one community to others in the region. Criminals do not confine their activity to the jurisdictions in which they reside.

Yet, while many problems facing cities and suburbs are regional in nature, regional solutions are difficult to fashion because of a lack of regional governance mechanisms to facilitate them. The typical American metropolitan area is governed by large numbers of general- and special-purpose governments and authorities. The need for regional governance has increased as the population has moved to fragmented suburban settings, but there has been little institutional response. Instead local concerns, like increasing the local tax base and minimizing local burdens take precedence over regional concerns, such as job-housing mismatches, air quality, economic and racial segregation, and fiscal inequities. Coordination among local jurisdictions does exist, but it tends to be ad hoc and conducted through a variety of inter-local agreements. These are useful and certainly should be encouraged, but they are not sufficient. Meanwhile the recognition of the need for regional responses is growing and in many areas is being met by the growth of regional activity among private and non-profit groups, sometimes with the participation of local governments, and often funded partially or wholly by local foundations.

To encourage and increase action that addresses regional level problems and seizes regional opportunities, we recommend the following.

Recommendation 2.1: HUD should propose new legislation that would create a “Regional Challenge Grant Program,” a multi-year competitive grant program for proposals designed to have a regionally significant impact. Proposals could be for purposes that were directed towards any of a variety of important national objectives as they relate to metropolitan areas. Such objectives could include:

- Regional economic competitiveness
- Provision of affordable housing
- Sustainability and “smart growth” objectives
- Creation of mixed-use, mixed-income communities
- Improving housing, transportation, and land use links and housing-job mobility
- Environmental, climate change, and energy reduction objectives
- Equity objectives such as modifying fiscal disparities among local governments or fair housing.
- Other activities consistent with national objectives that have a regionally significant impact
- Some combination of the above

Proposals would not necessarily have to be across jurisdictional lines so long as they were designed to have a regionally significant impact. In order to provide fiscal benefits to local governments throughout the region for the fiscal return of the activity (and to make it possible to reach regional agreement), the proposal would have to include a plan for the local jurisdiction(s) in which the project would be located to place at least 25% of the additional tax revenues generated by the project in a region-wide tax sharing fund. An alternative option would be not to require such a plan, but for HUD to announce that it would give substantially higher priority to proposals that included the plan.

The Regional Challenge Grant (which could be seen as a “Regional Development Grant”) would encourage regional entities, jurisdictions within metropolitan areas, and/or state governments to collaborate in proposing activities tailored to the circumstances of their particular region. Proposals could come from any of these three entities or some combination of them, so long as the proposals were for activities that would have a regionally significant impact and were directed towards one or more of the objectives stated above. However, to be eligible, the actual proposal would have to be submitted to HUD through a regional entity and would have to reflect broad agreement among local elected officials, including the mayor(s) of the principle city (or cities) of the metropolitan regions, the county executive or council of the largest counties, and suburban officials. There could be additional provisions requiring

some level of participation by the private sector, non-profits, foundations, and community groups, but these would have to be structured so as not to provide a multiplicity of veto points and to avoid interminable negotiating. Funds would be available to winning proposals for a multi-year period.

This process could be characterized as a form of “reverse RFP.” Extra consideration could be given to applications that crossed functional areas – e.g., proposals that combined some combination of housing, transit, economic development, environment and pollution control, etc. or focused on “green,” sustainable, and/or equitable development.

While HUD would be the primary home of the program, it would require HUD – or, more likely, the new White House Office of Urban and Metropolitan Policy with HUD’s support – to act as a facilitator to help package activities, funds, and, if appropriate, waivers across the various federal departments and agencies responsible for the different policy areas. It is likely a program this complicated will require the new White House Office of Urban and Metropolitan Policy – an entity that can speak directly for the President – to coordinate this, bring the other departments on board, and ensure cooperation.

It is worth noting that towards the end of the Clinton Administration HUD proposed a “Regional Connections Initiative” that was similar in some respects to the Regional Challenge Grant that we recommend. Also both New York State, in its 21st Century Demonstration program, and the Commonwealth of Virginia through its Virginia Regional Competitiveness Act have programs designed to encourage regional activities.

Recommendation 2.2: HUD should modify CDBG (and possibly the Home Investment Partnership Program) to provide incentives for regional activity and, at the same time, to encourage and strengthen regional governance processes. The essential idea would be to provide additional funds for these programs that could be used only for regional purposes. In his campaign President Obama suggested that CDBG funds, whose real value has been reduced substantially over time, be increased. *We recommend that one-third of any increase in CDBG entitlement funds should be set aside for activity to accomplish regional purposes*, leaving the other portion for increases in formula allotment to entitlement communities and for the state non-entitlement program (thus providing local governments with desperately needed funds and reducing their immediate opposition to the regional set-aside). Only one proposal could be submitted per region so some regional entity would have to be empowered by local governments within the region to determine which proposal to submit.

There are two options for distributing the set-aside funds:

- Option 1: Competitive grant. The funds could be held in a separate pot by HUD and allocated as a competitive grant to regions that submitted the best proposals for CDBG activity to accomplish regional purposes. More favorable consideration or higher funding amounts could be given to applications that were addressed to particularly high priority national objectives such as transit-oriented development, compact development (or other “smart growth” objectives), or regional economic competitiveness. Applicants would have to be either a consortium of local governments or a regional entity, with proposals submitted by the latter given more favorable consideration. The funds would be usable only for CDBG eligible purposes that were regional in nature.
- Option 2: Formula-based distribution. The funds could be allocated to each metropolitan area in the same proportion as the funds currently being allocated to the entitlement communities within the area. Thus, if the total regional set-aside amounted to an increase of 15%, each metropolitan area would be allocated an additional amount equal to 15% of that going to the entitlement communities. However, the funds would be usable only for CDBG eligible purposes that accomplished regional objectives and were proposed by a regional entity. HUD would have to determine whether the proposal would accomplish regional purposes.

Alternatively, the set-aside funds could be split with the two resulting parts each being used to fund one of the options.

The rationale for the competitive grant option – the one that a substantial majority of the task force favored – is that it would be a productive investment of scarce federal resources which could result in activity with substantial benefits in those regions that had the capacity and proclivity to undertake it. It would provide an additional incentive for regions that already understand the importance of regional activity to take greater strides in that direction. The

successful use of federal funds for regional projects would further support the notion that regional activity is viable and that federal funds are well-spent when directed to such projects (rather than being seen as further evidence of federal monies being wasted on ill-conceived projects). The argument against is that it would not provide incentives for the regions that are most lacking in regional governance capacity – arguably the regions that need it the most.

The rationale for the formula distribution option is that it would build regional governance capacity in many more places. The benefit in this approach would be captured through the additional regional governance capacity as well as through the actual regional activity undertaken. Also, distribution of funds to a larger number of recipients would serve to build a stronger political constituency for HUD regional programs. The argument against this approach is that spreading limited federal resources across a large number of places would likely yield a lower return on total investment. Also, the requirement that HUD review each proposal for *bona fide* regional grantees and purposes could exceed existing HUD capacity.

Regardless of which option is chosen, existing CDBG legislation would have to be altered in significant ways.

Recommendation 3: HUD should help to bring about effective regional governance in metropolitan areas.

The fundamental challenge in fashioning and implementing effective policy at the regional level is the current weakness and scattered nature of regional governance mechanisms through which bargaining, negotiating, consensus-building, decision-making, and, ultimately, implementation can take place. The typical metropolitan area consists of a large number of independent general purpose local governments – cities, suburbs, counties, and, in some cases, townships. While there are frequently single-purpose special districts at the regional level, particularly for infrastructure-related concerns, there generally is no multi-purpose regional governance institution. The collaboration and cooperation that does exist occurs through large numbers of individually negotiated ad hoc agreements among the independent units of local government, frequently on a bi-lateral basis.

Virtually all metropolitan areas *do* have regional planning agencies, usually funded at least partially through federal programs. The only regional planning agencies that plan across functional lines to some degree are the Regional Councils of Government (COGs). However, COGs generally have little or no strong, reliable source of funding for this purpose; in effect, they follow the money and play a regional role for those policy areas for which federal and/or state functional money is available. Because of their voluntary structure, councils of government serve on most issues largely as venues for discussion among local government leaders in the region, a very valuable function in its own right but not always sufficiently empowered to achieve needed solutions to urgent problems. Metropolitan Planning Organizations (MPOs), many of which are COGs, are probably the strongest regional organizations, both because some federal transportation money runs through them and because they have a limited mandate to crosscut silos linking environmental and land-use concerns to transportation.

Historically HUD played a key role in the development of regional planning agencies. In the 1960s and 1970s, HUD was a leader in facilitating the nationwide spread of regional planning. HUD's Sec. 701 planning grants provided important "glue money" to support multiple-purpose metropolitan planning organizations (usually COGs) throughout the United States. By the end of the 1970s, virtually all metropolitan areas had such organizations – and most areas still have them today.

But this multi-function coordinative focus was lost in the 1980s. HUD lost the last portion of its Sec. 701 program (the regional portion) in 1980. This action by Congress and the President removed much of the "glue money" that was beginning to institutionalize capable regional analysis and collaboration among staffs and policy forums that reached across single-function programs. This was, moreover, not the only loss; at the same time, many other regionally oriented federal-aid programs also were cancelled. Since transportation and economic development programs cannot survive without population and land-use projections, the main ones that did survive – DOT's metropolitan planning program and EDA's regional economic development program – had to individually recreate and fund the demographic analysis, land-use planning, and area-wide housing strategies that had begun to be provided using HUD's 701 program.

Given the present weaknesses and stove-piped nature of these regional governance institutions, it is appropriate and vital that the federal government help strengthen regional governance as a means of producing effective regional action. The logic for this extends back to the language in HUD's original mission. The importance of regional

governance relates not only to metropolitan economies, which are the backbone of the American economy. The capability to coordinate will also become increasingly essential as the nation tackles the challenges of energy efficiency, stronger utilization of alternative sources of energy, CO2 reductions, and climate change. The demand for coordination is far outstripping the ability of current metropolitan institutions to provide it.

The recognition of the increased importance of regional approaches as a means of meeting challenges and taking advantage of opportunities suggests that *HUD should take the lead in new efforts to strengthen regional governance mechanisms at the metropolitan level.*

There are a variety of ways this could be accomplished. We have already recommended that the CDBG add-on and the Regional Challenge grant proposals come from a regional entity. In addition, we recommend that:

Recommendation 3.1: HUD submit legislation to provide general operating funds (“glue money”) for a designated multi-purpose planning agency in metropolitan areas. The funds would be available, by application, to only one organization in each metropolitan area. The organization would be designated by the region in its application and could be an existing organization or a new one. The recipient agency should be required to establish links with the other regional planning bodies in its jurisdiction, produce a regional land-use and growth management plan suitable as the foundation for other single-function planning, and help to coordinate the tracking of progress toward achieving performance goals and targets established by regional plans. The legislation should also provide additional funding if this agency were also the locus for other regional planning functions such as transportation, pollution control, infrastructure, energy management, environmental conservation and climate change, the sustainability of national defense installations, and jobs-housing balance. In addition it should require any HUD regional planning activity, such as those related to its Consolidated Plans, to be the responsibility of this agency.

Recommendation 3.2: HUD should seek new legislation (or it could be a part of the legislation for operating funds for a designated regional planning agency) for the recipient regional agency to produce or contract for production of a periodic “State of the Region Report.” In regions where a regional organization already produces a “State of the Region Report,” the recipient regional agency should work cooperatively with the producer of the pre-existing report to prevent duplicative efforts.

Recommendation 4: HUD should play the lead role in efforts to break down (or provide crosswalks to connect) programmatic silos that, at both the federal and regional levels, impede effective responses to metropolitan area needs.

1. At the federal level

At the federal level no department has primary responsibility for the challenges and opportunities of our metropolitan regions, despite the fact that HUD’s original mission in 1965 explicitly assigned this responsibility to it. The failure of federal government agencies to coordinate policies harms metropolitan areas in myriad ways. For example, at the same time that CDBG is trying to revive distressed urban neighborhoods, federal transportation policies build highways that promote suburban flight.

The Executive Branch of the American federal government is based primarily on function rather than place. The consequence of this is that policy is seldom directed in a comprehensive and holistic way across functions and jurisdictions to urban and metropolitan areas, areas that comprise the functional economies and social systems of most of the United States.

The legislation creating HUD stated, *inter alia*, that “the Congress finds the establishment of an executive department is desirable... to assist the President in achieving maximum coordination of the various federal activities which have a major impact upon community, suburban, or metropolitan development.” We urge that HUD embrace that purpose.

At present, programs related to cities and metropolitan areas reside in many federal agencies and departments, including, in addition to HUD, the Department of Transportation, the EPA, the EDA of the Department of Commerce, the Department of Labor, the Department of Health and Human Services, and many others. Each of these departments is naturally concerned with fulfilling its own missions and protecting its own interests and

constituencies. HUD, as one of these departments among equals, is unlikely to be able to play the lead role in breaking down these “silos.”

The inability to bring the resources of the federal government to bear upon urban and metropolitan area concerns in a coherent fashion was a major reason why, during the presidential campaign, candidate Obama suggested the creation of a White House Office of Urban and Metropolitan Policy (WHOUMP). Our recommendations assume the creation of this new office, one of whose primary objectives will be to place the power of the Presidency behind achieving greater coordination among the urban and regional related programs dispersed among many federal agencies. Assuming the existence of WHOUMP, we recommend that:

Recommendation 4.1: HUD, as the federal department with the most explicit urban and regional mission, should be the lead federal agency in working with WHOUMP to achieve greater coordination among these programmatic silos, including detailing staff to assist in this endeavor.

Recommendation 4.2: In particular, HUD should work with the White House Office to set up an inter-agency task force to explore ways in which the urban and regional functions of the various federal agencies and departments can be more effectively coordinated.

Recommendation 4.3: In conjunction with the WHOUMP, HUD should play a lead role in bringing together resources across various federal agencies for a specific program. For example, in a Regional Challenge Grant program such as the one recommended above, HUD (or HUD, in conjunction with the new White House Office) should take a lead coordinating role in proposals that request resources from federal agencies in addition to HUD.

Recommendation 4.4: In addition, as the lead urban and metropolitan agency, HUD should compile and update an inventory, for the use of both federal and state and local governments, of programs affecting urban areas throughout the federal government and how these programs relate or could relate to each other.

2. At the regional level

At the local and regional level the same functional stove-pipes exist. Within the region itself local jurisdictions – the basic governmental units with which HUD interacts – are unable to successfully address on their own those concerns that are regional or extend beyond their boundaries. Metropolitan areas are stove-piped in two ways. First, individual local governments operate in a legally independent manner from each other. Coordination among local jurisdictions does exist, but it tends to be ad hoc and through a variety of inter-local agreements. These are useful and certainly should be encouraged, but they are not sufficient. The second set of stove-pipes are the individual service areas – housing, transportation, land use, environment, energy, education, economic development, workforce development, and others. Each of these individual areas is usually managed through functionally separate departments both within individual local jurisdictions and, more importantly, at the regional level where, if there is regional planning or activity at all for one or more of these functions, it is performed through a regional special purpose district.

These stove-pipes limit the potential for meeting challenges and taking advantage of opportunities at the regional level. For example, transit investments create higher land values, but without supportive housing and land-use policies, the full benefits of transit-oriented development (TOD) will not be realized. Suburban zoning regulations prevent many core city households from following the jobs out to the suburbs, creating job-housing mismatches that public transit systems are ill-suited to address and that have the added effect of significantly increasing the costs of housing construction as developers have to contend with a wide array of different planning systems. As dozens of studies have shown, the resulting concentrated poverty makes it almost impossible for many urban and inner suburban school districts to succeed.

HUD can encourage breaking down these stove-pipes at the local and regional levels.

Recommendation 4.5: HUD should require that its Consolidated Plan be coordinated with, and, if possible, prepared by the same agency that produces the region’s Transportation Improvement Program (TIP).

Recommendation 4.6: HUD should work with the new White House Office of Urban and Metropolitan Policy and with other federal agencies to require (or encourage through incentives) that other federal regional planning programs (such as those of the Department of Transportation, Economic Development Administration, Environmental Protection Agency, and Department of Labor, etc.) be funded through and be the responsibility of a common organization at the regional level, i.e., the organization designated above as receiving the “glue money.” HUD should encourage and participate in inter-agency task forces charged with coordinating their planning and action programs, developing and adopting relevant performance measures for use across agencies, and sharing data and best practices.

Recommendation 5: HUD should enhance urban and regional data collection, research, evaluation, and analysis capacity both at HUD and at the metropolitan level.

The ability to collect and analyze data and engage in research related to urban and regional areas is critical for understanding and responding to the challenges and opportunities facing these areas and their communities. Data and research are needed on the economic, social, environmental, and physical processes affecting these areas, on how policies affect these processes, and on the monitoring and evaluation of public programs and policies addressed to them.

At the regional level, the ability to collect and analyze regional data is essential for better regional policies and governance processes. Regional data can highlight trends that are problematic and help policy makers identify opportunities for investing public dollars. For example, in the recent foreclosure crisis, the availability of data on subprime lending was crucial to identify areas that needed foreclosure prevention counseling. Metropolitan areas are using sophisticated data to identify “transitional” communities where Neighborhood Stabilization Program funds could be targeted to prevent the area from sliding into contagious abandonment. Above all, data are needed to evaluate regional initiatives. We must create regional indicators to monitor progress on such issues as vehicle-miles traveled, job-housing mismatches, and energy consumption. Only this way, can regional initiatives be held accountable for results.

At present the capacity to engage in these activities is insufficient at both the federal and regional levels.

Recommendation 5.1: HUD, in conjunction with the new White House Office of Urban and Metropolitan Policy, should accept the primary role for identifying and providing the data required for understanding important urban and regional processes, challenges, and opportunities and the policies addressed to them.

HUD’s State of the City Data system is an excellent start on this and should be expanded. One useful expansion would be to create an on-line companion guide to the location of such data.

Recommendation 5.2: HUD should also identify critical gaps and shortcomings in data for urban and regional analysis and, again in conjunction with the new White House Office, establish interagency data standards, and prod appropriate federal agencies to collect and provide such data. For example, data on geographic disparities by income and tax base, the extent of land consumption due to urban sprawl, and the emergence of regional economic clusters will all require some rethinking of current categories and reworking of collection processes. However, such data would be exceptionally useful in conducting better planning for metropolitan competitiveness, sustainability, and inclusion.

Recommendation 5.3: HUD should enhance and expand the capacity of the Office of the Assistant Secretary of Policy Development and Research for urban and regional data collection, policy analysis, performance reporting, evaluation, and research. The unit should be responsible for collecting a broad range of data on metropolitan areas and their cities rather than simply data related explicitly to HUD programs. The organization contracted with to produce the biennial “Report on Urban and Metropolitan Areas” (such as the NRC) should establish an advisory committee on appropriate urban and regional indicators that HUD’s Office of Policy Development and Research would be responsible for collecting.

The research capacity that existed at HUD during the Clinton Administration has been severely diminished. HUD, as the federal agency that is in charge of urban and regional policy must establish a ‘world class’ research and analytical capacity. This can be done in a variety of ways – direct hiring, university or think-tank contracting, visiting scholar programs, support for the existing and an expanded journal; commissioning high-level national and international

conferences. In the absence of this kind of focus, we will limit our capacity for effective action both at the federal and at the state and local levels.

Recommendation 5.4: HUD should focus its research both on basic processes related to urban and regional systems and on policy concerns and policy approaches to attain national objectives. In particular, it should promote research on regional development processes and on the effects of policies designed to produce sustainable development within America’s metropolitan areas.

Recommendation 5.5: As one of only a few explicitly spatial departments in the federal government, HUD should become a central agent for the development and use of spatial statistics in order to support both its own research needs and its ability to interface with its customers through easy-to-use mapping systems. Such systems are increasingly common commercially and can be adapted by HUD through fairly straightforward customizations.

Recommendation 5.6: HUD should become a “customer friendly” provider of data for a variety of purposes and a variety of customers. An example of facilitating relationships with customers might be automating CDBG applications and linking them with standard data sources so that data could be used to evaluate progress over time based on an actual reporting of what was accomplished. The data collection, research, performance reporting, evaluation, and policy analysis functions are also missing or underdeveloped at the metropolitan level. Many metropolitan areas do not have an institution responsible for collecting, organizing, and analyzing data on economic, social, environmental, and physical conditions within the area.

In general, HUD should provide and/or utilize data:

- to promote better customer understanding and use of market trends and dynamics in order to make a case for the use of federal dollars;
- to communicate with customers through customized data-rich programs that will minimize the costs of the present system that is time-consuming and uneven;
- as a basis for distributing HUD funds and targeting federal assistance;
- as a way to report the performance of its own programs,
- as a way to evaluate program efficacy over time;
- as a way to build reports on regional and urban trends; and
- as a repository and resource for researchers.

Recommendation 5.7: HUD should make available funding for urban and regional data collection, reporting, and research to the regional entity that receives federal planning “glue money” in major metropolitan areas. The recipient would not necessarily be required to do the data collection, reporting, research, and analysis itself, but could contract with a regional institution, university, or research institute in the region (or more than one) to conduct the work. However, the funding should require a minimum core set of data that all recipients would have to collect and present in a common way to permit comparison across regions.

C. Immediate Policy Actions Related to the Economic Recovery Program or the 2010 Budget.

Recommendation 6: In the absence of the to-be-created White House Office of Urban and Metropolitan Policy, HUD should take the lead in assuring the regional entities are eligible to receive funding under the various relevant elements of the forthcoming economic recovery bill or the 2010 budget.

CHAPTER 7

A CITY-FOCUSED ECONOMIC DEVELOPMENT AGENDA FOR THE FEDERAL GOVERNMENT AND HUD

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

THE CHARGE

“... what our cities need isn’t just a partner. What you need is a partner who knows that the old ways of looking at our cities just won’t do, who knows that our nation and our cities are undergoing a historic transformation.”

President Barack Obama,
Outlining his “Metropolitan Strategy for America’s Future”
to the U.S. Conference of Mayors, June 21, 2008

During a presentation before the nation’s mayors on the campaign trail, President Barack Obama laid down a challenge to the Washington *status quo* when it came to cities: It’s time to rethink how the federal government supports and views American cities. Too long seen as a drain on resources, lacking in hope and opportunity, and bearing all responsibility for their failings, residents of urban America expect change from the new administration.

Candidate Obama rightly held cities up as the primary “building blocks” of the nation: Metropolitan areas account for 80 percent of the nation’s population and produce more than 85 percent of the nation’s wealth. However, the role that their core cities play in those regional economies varies widely.⁴⁷ To remain vital in a world where energy will become much more expensive, where global warming is a reality, and where competition takes place between city-focused regions in global markets, metropolitan economies have to become more than exit-ramp economies, places where the highest-valued economic functions are huddled around highway beltways. The future of oil-based transportation and oil-based regional labor mobility demonstrates how vulnerable “center-less” metropolitan economies will become. At the same time, leaving America’s historic core communities to be sandboxes for the poor and custodians of the nation’s social safety net denies the possibilities of renewing assets of land and people and connecting them to economic opportunity.

President Obama’s pledge to end the neglect of America’s metropolitan regions and his stated belief that the nation must “stop seeing our cities as the problem and start seeing them as the solution” represent a worthy goal and a considerable challenge for the U.S. Department of Housing and Urban Development (HUD). The new president and his administration must be positioned to make good on his promise to “rebuild and renew” the nation’s urban core communities as economically robust places to live and work. America’s core communities can be places of opportunity, value, and vibrancy. However, to achieve that vision of improved economic viability, these communities must also become places of safety, educational opportunity, and efficiency, with competitive costs and amenities. Restoring vitality to America’s beleaguered cities will require HUD, in partnership with other federal agencies, to address a variety of distinct but overlapping issues, from mitigating the effects of foreclosure, strengthening neighborhoods, and housing the homeless to supporting regional cooperation and championing a new urban form. This working group was charged with helping to craft a new urban economic development vision and action plan for HUD.

Real economic development investment for cities—defined here as efforts designed to facilitate the creation of goods and services, to make areas more economically competitive and viable, and to improve the income and job prospects of individuals—has been mostly absent as an explicit departmental policy objective. The purpose of this paper is to advocate restoring the urban development (the “UD”) function to HUD’s core mission.

⁴⁷ Edward W. Hill & John F. Brennan (2005) “America’s central cities and the location of work,” *Journal of the American Planning Association* 71(4):411-432

What is the rationale for federal involvement in economic development? There are two justifications that are broadly accepted, and there is a third practical reason. First, the federal government has an interest in improving the overall efficiency of the U.S. economy. This involves making investments that promote the productivity and wealth of the economy as a whole. The second is an equity consideration. Aiding lagging regions serves to stimulate structurally weak-performing regional labor markets, to better connect isolated places to the global economy, and to improve the earnings capacity of low-income individuals. The third, practical, reason is that the federal government can make large investments and internalize the return. It is a *de facto* source of capital, whereas many distressed cities cannot finance transformative projects.

The Department of Housing and Urban Development should take a primary role in making good on the President's promise of urban revitalization. The President's challenge and his decision to create a Cabinet-level White House Office of Urban and Metropolitan Policy represent an opportunity for greater reach, purpose, and effectiveness. The White House Office can be used as a tool for breaking down funding stovepipes and may provide a way to concentrate resources and efforts on revitalizing degraded assets. In fact, the mortgage and foreclosure crises, which have hit urban areas particularly hard, should themselves be seen as opportunities to reshape the urban landscape, accumulate and revitalize land, and reconnect isolated neighborhoods to broader regional economies. HUD's role in supporting regional economic development is to change the value of degraded land – getting core city locations into play as regional economic development assets.

There is a tension in our recommendations. The economy is regional, but HUD's traditional community development focus and tools should be used to help create selected neighborhoods of choice within the urban core. These neighborhoods can then become the basis for increasing the market share of regional economic activity and enhance the performance of the overall regional economy by providing residential choice and retaining young talent. In other words, HUD can help translate community development investments into economic development activity. This will require HUD to become involved in brownfield cleanup and land acquisition, to stimulate community building that uses anchor institutions and anchor amenities as building blocks of regionally competitive neighborhoods, and intentionally to provide linkages for low-income people to centers of regional employment. The goal of improving the market position of core city locations is to provide a center of jobs that is closer to the residences of modestly skilled workers and to improve the tax-paying and service-providing capacities of the city itself.

Any effort to revamp urban public policies as they relate to economic development must understand and address five challenges:

1. Investing in viable economic purposes for America's core communities.
2. Countering the profoundly negative impact that concentrated poverty has on revitalizing assets. To be blunt: Concentrated poverty deters investment, increases risk, and kills markets.
3. Responding to the need for investing in industries that use density as an asset and are poised for growth, such as new energy and environmental technologies and applications, as well as knowledge-using industries and business functions.
4. Supporting existing "anchoring" institutions, such as universities, hospitals, and major concentrations of skilled employment, and using "anchoring" amenities, such as waterfronts, downtown cores, and main streets to build neighborhoods of choice and diversity for both residents and businesses.
5. Connecting low-income people to regional labor markets and opportunity.

Specifically, there are six areas where HUD can play a pivotal role in supporting the economic redevelopment of the nation's urban core. These opportunities for greatest impact are:

1. Promoting green cities by investing in alternative energy technologies and increased recreational space.
2. Taking advantage of the opportunity that springs from the devastation of the foreclosure crisis to launch land-banking initiatives.
3. Reshaping cities around anchor institutions and anchor amenities.
4. Restructuring the Community Development Block Grant (CDBG) program to support economic development.
5. Providing the capacity for fundamentally restructuring the public finances of failing cities.
6. Working with the Economic Development Administration explicitly to tackle the endemic problem of brownfield cleanup and remediation, prioritizing the economic and transformative return from these projects. The Clean Ohio program can serve as a model.

The new HUD Secretary should create a framework for broadening the focus of the agency to assert itself in regional development issues separate from housing, understanding that there are two paths to an economic development function for HUD—a place-based economic development competition and an expanded block grant program.

OUR POSITION BROADLY

Over the past several decades, America’s urban core has changed in terms of function and specialization. However, urban policy has largely not kept pace with that changing landscape. Economic development policies must better reflect the different land-use and land-market realities and constrictions that challenge cities and put them at a distinct competitive disadvantage in attracting businesses and workers compared to their less-built-out competitors.

In general, there are two views on the importance of having core communities that are economically competitive. One view is that the core serves as an anchor or spark for economic activity that is distributed throughout the region. Regional economies are portfolios, or bundles, of goods and services. As products age, they attract competitors, margins decline, growth in sales slow, and employment and income growth stalls. The trick to having vital regional economies is to add new products and young businesses to the portfolio to counterbalance the negative impact of economic age and sclerotic performance. These new products are increasingly coming out of place-based anchor institutions – educational institutions, hospitals and their ancillary research operations, and private-sector labs. Additionally, site selectors are increasingly discovering that high-value-added portions of businesses are attracted to places that are locally thick in globally scarce talent. A good example of this is the decision made by Bridgestone Firestone to retain its product development and research facility in Akron, Ohio, rather than to move it to Nashville, where its North American headquarters is located. The decision pivoted around the importance of graduates of the University of Akron’s polymer chemistry program as a source of talent and the relationships that exist between the university’s graduates in the tech center and the College of Polymer Science and Engineering.

The other view regarding the importance of economically competitive core communities sees the core city as generating the image and infrastructure that enable regional economic function. Either view points to the need for strong cities at the center of regional economies. President Obama has highlighted this relationship in his call for strong regions, built on strong cities, built on strong neighborhoods.

There are five areas in which the development of metropolitan economies can be hurt by the social and economic decline of their core communities.⁴⁸

1. Core communities serve as hubs for many critical infrastructure systems on which the productive capacity of the entire metropolitan economy depends: air service, broadband and other telecommunication systems, rail and interstate highway freight systems, and, frequently, water and sanitary systems. Deterioration in public capital will increase operating costs across the region.
2. As the federal government has pushed the cost of supporting the poor to states and counties, central counties have been burdened with the increased fiscal cost of health care, education, and social service provision. This has increased the operating costs of firms located in these counties. There is a direct tie between the increase in local tax burden in providing support for the poor and the decreased competitiveness of urban county locations.
3. Increased operating costs will result in firms and people with means moving to avoid these costs. Operating efficiencies may be lost and labor markets may work less efficiently as a result. Additionally, city residents with limited transit access will become increasingly isolated from work opportunities.
4. In metropolitan areas, where local taxes play a large role in supporting public K-12 education (and at times higher education, as well), job sprawl and the resulting loss of fiscal resources will affect the future productivity of the workforce.
5. The physical condition of the core city will affect investment risk perceptions for the entire region and influence the ability of the region to attract talented migrants (both domestic and international) who have locational choice.

⁴⁸ See Edward W. Hill, Harold L. Wolman, & Coit Cook Ford, “Can suburbs survive without their central cities? Examining the suburban dependency hypothesis,” *Urban Affairs Review* 31 (2), November 1995: 147-174.

The “urban core” of far too many regions is either crumbling or under stress. This runs the spectrum from many of the nation’s aging, industrial cities to older urban centers and places dominated by deteriorated greyfields of 1950s and 1960s strip development. Special difficulties are encountered by those cities whose neighborhoods and former industrial sites have a core of concentrated poverty. There is a strong negative relationship between concentrated poverty coupled with abandoned land uses and the prospect of revitalizing land. In short, concentrated poverty drives out investment, wealth, and resources, thus making redevelopment difficult.

Concentrated poverty presents its own, self-reinforcing job-growth challenges. As the global economy has allowed low-skilled manufacturing jobs to move, employment options have dwindled for residents of the urban core, who tend to have lower levels of educational attainment and lack the job skills and readiness to access the high-tech and service-industry jobs of today’s knowledge economy. Additionally, as core cities have lost population—especially people with means—they also have lost population-serving employment. This disproportionately hurts modestly skilled individuals and young people who are attempting to enter the world of work. In too many neighborhoods in formerly industrial cities, the question is not, “Will we have a future of lousy jobs?” It is: “Will there be a future with any jobs?” In many of these areas, social service interventions have outpaced any real economic development investment.

The strategies presented here recommend a renewed and broadened focus for HUD. However, in its efforts to reorganize and reestablish itself as the champion of urban policy, the department should heed the two central messages that then-candidate Obama had for the nation’s mayors:

- The complex, wide-reaching challenges that are weighing down so many of America’s cities necessitate a collaborative effort uniting all levels of government and all appropriate departments.
- The fundamental path for change is bottom-up, not top-down.

HUD’s role in a new administration committed to urban revival should be to oversee and facilitate efforts that are initiated and carried out at the local and regional levels. Additionally, HUD needs to coordinate, leverage, and link resources in other federal agencies—Education, Labor, Transportation, the Economic Development Administration in Commerce, and, in some instances, the economic development resources of the Department of Agriculture. HUD has the ability to envision and espouse new urban forms, to fund and support local organizations that have the skills and knowledge of their particular community needs to enact change, and to provide serious evaluation of the effectiveness of programs. Think of HUD’s new challenge in terms of three Ls: learning, leveraging, and linking.⁴⁹

Over the years, HUD’s mission has devolved from its early emphasis on housing and transformative urban development. Views on the ability of federal government to stimulate economic activity are very different today than when President Johnson saw HUD as a key contributor to the Great Society. In the early 1960s, cities were relegated to service provision; real urban development authority frequently rested with the state through its investments in transportation and infrastructure. Today, cities are the primary champions of redevelopment, identifying needs, pursuing funding, and overseeing implementation. However, these efforts often boil down to structure-building, not community-building, partly because of the inflexibility and lack of coordination of funding programs. Today, more and more city leaders understand the interconnectedness of economic development, job training, education, transportation, and other activities in addressing the challenges of poverty, crime, and unemployment. A HUD charged with reinvigorating beleaguered cities must align programs to this reality and form bonds with other government departments to effect change in an era of tight resources.

ECONOMIC DEVELOPMENT AND HUD: A BIT OF HISTORY

Traditionally, HUD has been a major force in financing and stimulating real-estate-based development in America’s cities. Over the years, HUD’s development focus has shifted from Urban Renewal to Model Cities to CDBG to Urban Development Action Grants (UDAG).

⁴⁹ This is the subtitle that Dick Thornberg used in his article that summarized the National Academy of Public Administration’s review of the Economic Development Administration: “A path to smarter economic development: Learning, leveraging, and linking,” *Economic Development Quarterly* 12 (November 1998): 291-298.

A. Urban Renewal

The controversial Urban Renewal policy dramatically altered the urban landscape from the 1940s through 1970s by razing buildings, relocating residents, and invoking eminent domain in an effort to redevelop central cities. The economic activity sparked by Urban Renewal efforts came at a cost of urban sprawl, destroyed neighborhoods, and poorly utilized land. The controversy and legacy of Urban Renewal efforts should serve as a reminder that economic and community development do not necessarily operate in concert. HUD's mission today must be to develop strategies that revive the economic engine to revitalize communities, not destroy them.

However, we must also keep in mind successes from Urban Renewal, such as Philadelphia's Society Hill development. Society Hill is Edmund Bacon's well-designed transformation of Philadelphia's Dock Street food distribution district and adjacent collection of 18th and 19th century row houses into a vibrant, mixed-use neighborhood that anchors Center City's south side. It is a notable success of the original Urban Renewal program and an early example of the benefits derived from historic preservation. Additionally, Society Hill points to the importance of connecting both anchor institutions and amenities to a neighborhood-building effort to improve the core city's position in the regional economic development market.

B. Model Cities

As one of the weapons in President Lyndon Johnson's War on Poverty, Model Cities was a bold federal aid program to urban areas. Authorized in 1966, partly in response to criticisms of Urban Renewal efforts, the aim of the Model Cities program was to broaden HUD's mission and to better coordinate existing federal efforts to improve cities and to focus intently on low-income individuals and low-income neighborhoods. The program ended in 1974, after retreating from early goals of comprehensive planning and citizen involvement. The Model Cities program was replaced with CDBG program in 1976 under President Gerald Ford. The strength of CDBG is its bottom-up approach to meeting local service and investment demands of cities with low-income populations and was easily contrasted to the top-down approach of Model Cities. Although CDBG kept a strong focus on low- to moderate-income families and the neighborhoods they lived in and required low-income residents to participate in their communities, the role of city administrations came into ascendancy under the program. Although CDBG is the next program chronologically, it is HUD's longest-running program supporting cities with low-income populations. We reserve our comments about CDBG until a later section of this paper in which we discuss possible restructuring of the program.

C. UDAG

In the late 1970s, the HUD Secretary was given authority to distribute UDAGs to cities and urban counties that had demonstrated success in providing access to housing for low- and moderate-income residents, particularly minorities. UDAG was a supplement to CDBG. HUD awarded \$4.6 billion over 12 years (1978 to 1989) to approximately 3,000 development projects in 1,200 cities. Michael Rich concluded that one of the important benefits of the strategic orientation of the program was to transform "local economic development policy from one based primarily on a donor mentality that emphasized tax abatements and infrastructure improvements to a more entrepreneurial approach that emphasized the recapture of public funds."⁵⁰

The UDAG program was very large and did, in fact, allow cities to transform their core. Ultimately, however, UDAG proved to be a flawed model for urban economic development. The UDAG program espoused and funded the notion that the best way for central cities to compete with booming suburbs was by imitating parts of those same suburbs. In other words, it tried to replicate exit-ramp commercial and retail development in the core. What the program ignored was the attractive power of quality residential neighborhoods serving as the backbone of suburban America. UDAG funding resulted in a flurry of construction activity, enabling cities to build large-scale office and retail developments, often in the form of colossal high-rise towers, but these efforts did not transform the economic

⁵⁰ Michael J. Rich (1992) "UDAG, economic development and the death and life of American cities," *Economic Development Quarterly* 6(2): 150-172

environment of cities. The UDAG-supported projects did not have a goal of creating diverse downtown neighborhoods where people could both live and work.

D. Empowerment Zones

In 1994, the Clinton Administration supplemented CDBG with the Empowerment Zone (EZ) program, which allocated development resources to “highly distressed” rural communities, as well as to urban ones. Empowerment Zone designations, along with Renewal Communities and Enterprise Communities, allocated grants, business tax credits, bonding authority, and other benefits to communities of high poverty and high outward migration. The Empowerment Zone program is set to expire December 31, 2009.

Our working group panelists noted that the program’s competitive structure, designating two tiers of “winners,” promised benefits sufficient to hold together a Congressional coalition that supported the program. How successful was this program that largely used tax incentives and was tightly focused on job creation in distressed neighborhoods? The Empowerment Zone program was evaluated in a recent publication and commented on in another.

Busso and Kline compared EZ communities with similar neighborhoods that did not receive EZ designation.⁵¹ They concluded that EZ designation improved local labor market performance and resulted in increased housing values. They wrote that “it appears that the combination of tax credits and grants can be effective in stimulating local labor demand in areas with very low labor force participation rates...;” the impact “does not appear to have been captured by the relatively well off ... even young high school dropouts experienced improved labor market prospects ...; treated communities appear to have avoided large scale gentrification...” (pp. 29-30). The authors cited program costs ranging between \$1 billion and \$3 billion dollars.

In reviewing Busso and Kline’s work in a recent publication, Glaeser and Gottlieb applauded the quality of the work but cautioned against some of the interpretations of results after considering the cost of the EZ program.⁵² In particular, Glaeser and Gottlieb noted the findings that population in the EZs did not increase, that poverty rates fell by 5 percent, and that unemployment rates fell by 4 percent, compared to the control group, but that there was no appreciable increase in earnings. Using the high end of Busso and Kline’s cost estimates, Glaeser and Gottlieb concluded that the cost per job created was \$100,000. However, the public cost per job could not be calculated. Glaeser and Gottlieb concluded that place-based development policies were expensive ways to address poverty.

What is to be learned from the evaluations, including earlier work by Abt Associates and the Government Accountability Office? Business creation was low; firms moved into the zones to take advantage of the incentives. The value of housing increased, benefiting homeowners and costing renters, but gentrification was not a problem. Labor market outcomes were consistent with localized low-skilled markets that experienced an injection of demand. Unemployment rates dropped, young dropouts benefitted, but earnings remained flat. This is consistent with labor markets with weak demand and large supply that experience a demand shock. The caution is that the cost per job created is high, especially when compared to the wage earned.

The EZ program differed from the UDAG program in that the EZ program’s goal was to improve low-income communities as business environments by offsetting negative locational effects with cost subsidies and providing additional incentives to hire low-income neighborhood residents. The EZ program was not designed to change the economic base of the city itself. A major economic development question has not been answered: Can better labor market outcomes be achieved at lower cost by investing in developing higher quality, mixed-income neighborhoods that are connected to anchor institutions, anchor amenities, or anchor nodes of employment? The hypothesis is that these competitive places will generate more work and better labor market outcomes for low-skilled individuals in population-serving and employee-serving occupations. Our review of the evidence to date is that connecting diverse competitive core-city residential neighborhoods to areas that meet HUD’s low- to moderate-income test, rather than

⁵¹ Matias Busso & Partick Kline (2008) “Do local economic development programs work?” Evidence from the federal Empowerment Zone Program, Yale Economics Department Working Paper No. 36. Available: <http://www.econ.yale.edu/ddp/ddp25/ddp0036/pdf>

⁵² Edward L. Glaeser & Joshua D. Gottlieb, “The economics of place-making policies,” *Brookings Papers on Economic Activity*, (Spring, 2008): 47-48. Available: <http://www.brookings.edu/economics/bpea.aspx>

attempting to steer major economic development into low- to moderate-income neighborhoods, may generate more jobs at less public cost and change the competitive position of the core city in the metropolitan economy.

THREE LESSONS LEARNED

The working group assembled for this policy briefing has identified six distinct but intersecting economic development roles HUD could play in achieving President Obama’s goal of restoring the vitality of the nation’s urban core. These opportunities were mentioned earlier in this report. The working group also identified three principles that an urban economic development strategy must embrace.

A. Visible support from the President is required.

If the goal of the new administration is seriously to restore the “Urban Development” aspect of the HUD mission, the department must break out of the narrowly defined focus it now finds itself in. It must reach out to other critical government partners to take a comprehensive, coordinated approach to reviving urban environments.

The Clinton Administration’s model for Empowerment Zones may be particularly instructive as a guide for HUD’s renewed economic development function, especially given President Obama’s stated plan to elevate urban policy to a position in the White House. A lesson taken from the Empowerment Zone program is the need for a high-ranking champion who can unite various government departments and break down the stovepipes. Departments with intersecting roles often wrestle with conflicting mandates. During the Clinton Administration, Vice President Al Gore served as that champion, imparting prestige and presidential authority to the effort.

Similarly, President Obama’s choice to create a White House Office of Urban and Metropolitan Policy telegraphs a level of importance. Exactly how important will be gauged by the authority and weight of the person who holds the position. The Office of Urban and Metropolitan Policy should become the “fulcrum” for leveraging change, breaking down rigid departmental barriers, and demanding that HUD, Commerce, Transportation, Labor, and all other appropriate departments work together toward a new vision for urban America.

B. Doing things differently: Interagency coordination and cooperation is needed.

Other departments of the federal government do perform economic development functions. Unlike HUD’s constrained and watered-down economic development focus, the Economic Development Administration (EDA) in the Department of Commerce is relatively efficient and effective at assessing the potential value of proposed development efforts and distributing the funding necessary to make them happen. The EDA’s economic development mission has not been constrained by the income levels of the neighborhoods targeted for investment.

It may be helpful to explain exactly how we are defining economic development. The purpose of economic development is to create a set of goods or services that can be sold or traded outside of a metropolitan area. The EDA and the Manufacturing Extension Partnership, a program of the National Institute for Standards and Technology, tend to focus on this aspect of economic development. Economic development may also describe efforts to improve the competitive market position of metropolitan areas within regions. The former Urban Development Action Grant program attempted to help communities with this economic development function. Economic development efforts may also be targeted toward improving the income and job prospects of people who are isolated from the labor market. This traditionally has been, and rightly should be, a mission of the Department of Labor. The Secretary should make it HUD’s objective to focus on the second function—improving cities as competitive markets—to help provide demand that stimulates the third function of economic development, improving income levels and job prospects of citizens.

The only way to improve the lives and prospects of low-income workers and families is to restore economic vitality to the communities in which they live. Building better roads and more off-ramps is an element of economic development, but such activity will not achieve President Obama’s stated goal of promoting “strong cities as the

backbone of regional growth.” Constructing off-ramps and roads so that businesses can relocate farther outside the central core does little to improve the lives of low-income workers who lack cars or other transportation options to access jobs outside their neighborhoods.

Investing in job skills and transportation must go hand-in-hand with economic development investments to help beleaguered cities transform themselves into competitive locations that will be attractive to businesses and individuals. This insight points to the fact that, even with a renewed emphasis on economic development, HUD acting alone cannot achieve President Obama’s vision of strengthened cities. HUD must reach out to other government departments pursuing urban strategies in order to bring about lasting change.

There is important work to go around for all departments. Although a HUD with a reinvigorated economic development function would overlap some of EDA’s work and reach, HUD and EDA should not see themselves as competitors, but as valuable partners in helping the nation’s cities overhaul and fine tune their economic engines.

C. All core communities must see relevance.

The brilliance behind CDBG is that all communities have benefited, and large parts of Congress have an interest in its continuance. The lesson drawn from this success is that HUD’s economic development role should not be confined to serving just the needs of the nation’s older, industrial cities. However, there must be acknowledgment and understanding that many cities have lost function, are weighed down by a shrinking or dead industrial base, and will not be able to achieve economic recovery without the tools, guidance, and support necessary to deal with land-use challenges presented by the physical remnants of an industrial past and a damaged fiscal base resulting from declining property values. Therefore, the spectrum of interventions needs to be broad.

The Empowerment Zone program became a reality because the designations allowed many cities to benefit, and a Congressional coalition interested in their success was formed. The funded planning process provided knowledge and strategies for all participating communities and two levels of benefit—from the smaller number of better-financed Empowerment Zone Communities to the more numerous, but less richly funded, Enterprise Zone Communities. Competition allowed for targeting around desired federal outcomes.

RECOMMENDATIONS

Recommendation 1: Building diverse core neighborhoods around anchor institutions and anchor amenities.

HUD’s economic development role must be focused on helping make cities competitive within their own regions. Competitive cities today and in the future will become increasingly attractive when high fuel prices reassert themselves and global-warming concerns have greater influence over where people choose to live, work, and play. However, these cities must be safe and child-friendly to be economically sustainable. Beginning in the 1950s, cities were dramatically shaped by and heavily dependent on highway patterns. Economic opportunities repeatedly sprang up and grew along highway exit ramps. Urban sprawl, fueled by cheap oil and energy, emptied cities of jobs and people and led to communities of lower density. As a result, many central-city neighborhoods were left virtually isolated from opportunity.

In returning to, and expanding on, its urban development mission, HUD must learn from earlier failed experiments at city building. It should set its sights on envisioning a new theory of city building that is both flexible enough to allow urban areas in varying stages of growth and distress to address their specific needs and be focused enough to provide real guidelines for fundamental economic transformation. HUD must use its prominent role and its grant-making authority to discourage cities from throwing money at their weaknesses and, instead, encourage a master plan of urban rebuilding designed around unique strengths.

People tend to locate where they find economic opportunities, see attractive amenities, feel safe, deem the educational services available to their children acceptable, and trust that their housing choices will be rewarded with appreciating value. Those location criteria have not changed. The challenge to HUD, the new Urban Policy Director, and to all other relevant government departments is to envision and create a new urban form that allows cities to compete with

suburbs and exurbs as desirable residential and business options. That new urban form is not the traditional, dense, monolithic city. Focusing on creating many dense, safe, inviting neighborhoods that develop around their individual strengths and personalities will reposition the nation's urban areas to compete and win in a world with much more expensive fuel.

Cities need help to define and assess their anchor institutions and anchor amenities and to understand how economic growth can be built on these foundational assets. Institutions of higher education, hospitals, large corporations, and distinctive recreational experiences are examples of these anchoring elements. HUD's economic development funding should support cities in their efforts to build diverse, dense, and dynamic residential neighborhoods that link to these institutions.

The consequence of failing to truly transform the nation's urban landscape and to build a live-work core city neighborhood is clear: people tend to start businesses where they live. If no one lives downtown, business starts will be few. Businesses also spring up near unique talent pools. Until cities begin to focus more on the kinds of experiences and opportunities that attract these pools of talent, other business attraction efforts will likely fail.

Examples of successful anchored redevelopment include:

- West Philadelphia's "Penntification," which refers to the University of Pennsylvania's lead role in remaking the area once infamous for violent, destructive clashes with police into an inviting home for young professionals and families.
- Wooster, Ohio's involvement in the National Trust's Main Street program. As a result, storefront occupancy rates rose from 40 percent to 95 percent.
- Seattle's combination of small-scale, green, walk-able neighborhoods connected to either work or water.
- Portland, Oregon's dedication to transit-oriented development, with careful attention being paid to urban design.

Members of the working group envision a continuum of development activities targeted toward cities, beginning with linking Main Street programs to housing preservation programs at the low-cost end of the spectrum and extending to activities that link land banks to anchor institutions and amenities to relearn the lessons that Ed Bacon taught in Society Hill.

The role for HUD is to alter its traditional focus on neighborhood and community development so that neighborhood development serves as the springboard for economic development by improving the competitive position of core communities in their regional economies.

How does creating the next Society Hill in Philadelphia or Queen Anne Hill in Seattle change the life chances of low-skilled residents? It does so indirectly, as happens so often with market-based approaches to change. In weak-market central cities, the largest collection of low-skilled and semi-skilled jobs remains in the urban core. In cities with strong cores, such as Chicago, Seattle, and Washington, D.C., the working poor are moving to the edges of the metropolitan area in search of lower cost housing. The best way to expand employment for those with limited skills is to expand the pool of jobs serving higher-density city neighborhoods that combine places to work and live. If these "anchored" neighborhoods are connected to the rest of the city through public transit, spin-off jobs are created. The power is through linkages that exist between the anchored neighborhood and lower-income neighborhoods in the city. The power of place is magnified if housing is made available to lower income families as an intentional attempt to create income diversity in the anchored neighborhood.

Recommendation 2: Restructuring the Community Development Block program.

President Obama's intention of championing an urban policy presents an opportunity to revitalize the urban development arm of HUD. In name, HUD continues to be in the urban development business. However, all appropriated urban development money is currently channeled through Community Development Block Grants. CDBGs are, as the name implies, focused on community- and neighborhood-building activities.

The CDBG program, as one of HUD's longest-running development efforts, provides flexibility in responding to a wide range of development needs. Cities automatically qualify for CDBG funding if they have populations greater than 50,000 under two formulas, one which favors rapidly growing cities with low-income populations and expensive

housing and the other which favors cities with older, deteriorated housing stock and low-income populations. The 1978 reauthorization of the program set aside 30 percent of CDBG funding for states to allocate to rural areas.

During the Reagan Administration, the CDBG program changed its practices. Instead of requiring communities to apply and justify need in order to access funds, the program became one in which communities were guaranteed money, needing simply to account for how it was spent. This procedural change essentially shifted the focus of the program from funding strategic community development to supporting more neighborhood-oriented tactical projects, effectively diminishing HUD's urban development mission.

By law, the CDBG program has three mandates: eliminating slums and blight, meeting the needs of low- and moderate-income people, and responding to urgent community needs. However, one requirement – that funds be spent in low- and moderate-income neighborhoods – seems to trump all others. This may be a worthy policy goal, but it is a mandate that effectively prevents HUD dollars from going toward large-scale development projects that offer the potential of transforming and reinvigorating cities. Such a mandate focuses spending on neighborhood and community development, not on transformative economic development. And it prevents other important challenges from being addressed.

For example, many urban communities in the Northeast and Midwest face issues of environmental justice. They need help in cleaning up brownfields and addressing other challenges from their industrial pasts. Cleaning up environmental contamination where a responsible private-sector investor cannot be found should be considered an eligible CDBG activity under the elimination of slums and blight mandate – even if the low- and moderate-income requirements are not met. The old UDAG program did, in fact, support environmental cleanup and other industrial activities and allowed for land banking.

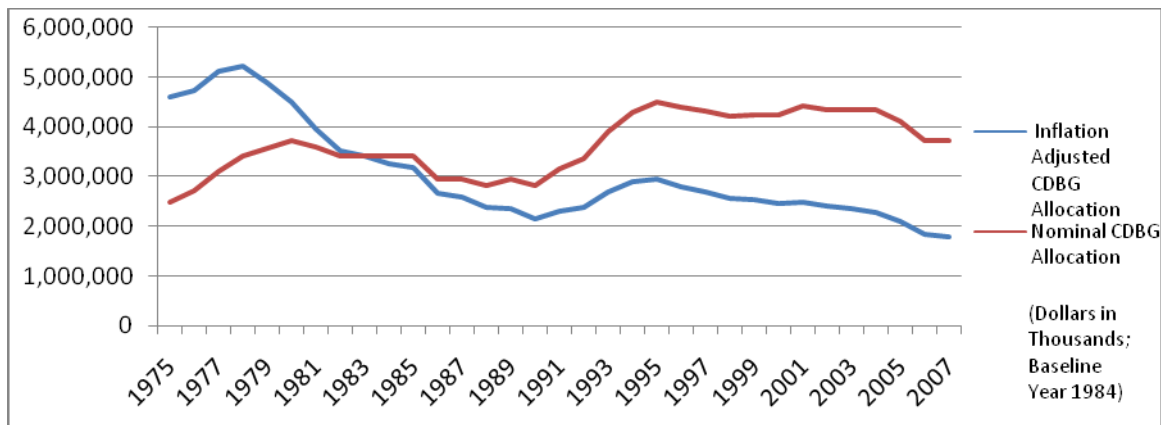
Over the years, CDBGs have devolved due to the lack of funding to the point that they are now less vehicles of urban development than tools of attempted fiscal equalization. Currently, communities allocate CDBG dollars toward job training and other workforce readiness activities. Funds are used in neighborhood development efforts – focusing on housing, storefront renovation, and social service provision. Some cash-strapped cities even put the money toward shoring up deficits in operating budgets, including public safety. CDBGs also provide cities with funds to address social service needs, but, in reality, most provide little investment in the kinds of activities that can improve economic function, dramatically change urban landscapes, and provide a competitive business or residential environment. They do not represent an investment in the capacity of core communities to compete for market share in a regional economy.

We do not recommend changing the way cities currently apply CDBG dollars, nor do we recommend reducing the current CDBG funding levels. Cities rely on that money for vital functions. Instead, the Secretary should recognize that HUD's community development mandate must be viewed as three distinct, yet intersecting, objectives:

- Social service delivery and job training,
- Fiscal equalization, and
- Economic development.

Each deserves its own block grant, and each needs its own formula for funding.

We strongly believe that bolstering HUD's economic development function cannot be at the expense of the other two community development functions. Funding for the kinds of economic development investments that may help cities reinvigorate their economies must be made from additional, or "new," money. That is, an expanded HUD appropriation needs to be specifically targeted toward urban economic development investment. As can be seen by the following chart, appropriations for CDBGs have declined dramatically over the past 30 years when adjusted for inflation.



Given the drop in the inflation-adjusted value of CDBG expenditures, it is easy to see how the pressures of meeting immediate fiscal and service needs have caused American cities with stagnant tax bases to allocate funding toward their operating, social service, and neighborhood stabilization budgets. Additionally, the focus of CDBG on low- and moderate-income residential neighborhoods has limited the opportunity for genuine economic development investments.

Economic development professionals have raised a number of issues about their ability to use CDBG funding for economic development purposes. These professionals consistently cite three problems in using CDBG funding as a tool to improve the competitive position of core cities in the market for business locations: tight targeting of benefits to low- and moderate- income individuals, the perception that the Section 108 loan program does not work, and the view that the Brownfield Economic Development Initiative is dysfunctional. We comment briefly on each concern.

HUD requires that 70 percent of CDBG funds be used to “benefit low- and moderate-income persons, and that the grantee will affirmatively further fair housing.” Additionally, the property acquisition guidelines state that real property can be acquired if it “will be used for an activity the benefits of which are available to all residents in a particular area that is primarily residential, and at least 51 percent of those residents (or fewer if exception criteria apply) are L/M [low or moderate] income persons.”⁵³ The same low- to moderate-income targeting applies to property acquired as an economic development activity: “the property acquired is to be used for an economic development project that will create or retain permanent jobs at least 51 percent of which will benefit L/M income persons.” The complaint among economic developers is that the target that 51 percent of the beneficiaries be low- to moderate-income rules out projects in which numerically more low-income individuals stand to benefit, but low- to moderate-income individuals do not constitute 51 percent of the beneficiaries. The secondary observation is that projects with the highest employment and income benefit potential for low-income workers are more likely to be outside of low-income neighborhoods.

The consensus among economic development professionals is that CDBG is aptly named; it is a community-development program and not an economic-development program.

HUD offers Section 108 loan guarantees to CDBG entitlement communities. HUD states that Section 108 is a source of financing for “economic development, housing rehabilitation, public facilities, and large-scale physical development projects.” HUD claims that Section 108 loan guarantees are among “the most potent and important public investment tools that it offers to local governments.” Economic developers say, “Not so.” Section 108 is a credit enhancement, allowing local governments to borrow funds and guarantee the loans by pledging current and future CDBG allocations as security against loan default. HUD notes that there have been no defaults to date.

The problems raised by economic developers are that the underlying security remains a loan and is not equity or funds that can be used to write down an investment; the location of the investment still must meet the low- to moderate-

⁵³ Community Development Block Grant Entitlement Communities Grants. Available: www.hud.gov/offices/cpd/communitydevelopment/programs/entitlementcommunities
State Community Block Grant Program, Categories of Eligible Activities, Page 2-8. Available: <http://fhadirect.hud.gov/offices/cpd/communitydevelopment/library/stateguide/>

income criteria where there frequently is not a market for the project; and the deal offered to local officials is Hobbesian. In other words, communities can pledge their future CDBG funds to get a development project, but if the project fails, then future social and community development services supported by CDBG allocations will be lost.

One working group member interviewed stated that only 8 percent of CDBG funds are used to support economic development projects and that these are not done by entitlement communities but by state CDBG programs. If there is a market test that demonstrates the utility of CDBG in supporting economic development, CDBG has failed that test.

The third area of dissatisfaction among economic development professionals is the ability to use CDBG to clean up brownfields. HUD offers the Brownfields Economic Development Initiative (BEDI) and suggests that it be used in conjunction with the Section 108 loan guarantee program. BEDI grant funds are designed to assist with the redevelopment of abandoned, idled, and underused industrial and commercial facilities “burdened by *real or potential* environmental contamination.” The program is targeted toward “the redevelopment of brownfield sites in economic development projects and the increase of economic opportunities for low- and moderate-income persons as part of the creation or retention of businesses, jobs and increases in the local tax base.” HUD “does not encourage applications whose scope is limited to only site acquisition (i.e., land banking), where there is no immediately planned redevelopment.” The stated purpose of the program is to “spur the return of brownfields to productive economic use...”⁵⁴

There are several reasons for economic developers’ frustrations with the program. (1) Companies typically do not want to wait the multiyear periods needed to obtain the land, apply for funding, and clear and rehabilitate the site. The end-user requirement is a major hurdle. (2) The low- and moderate-income targeting requirement as currently interpreted is a significant problem. (3) Not all problematic properties pose environmental hazards. Economically obsolete and dangerous properties (also known as greyfields) should be eligible. And, (4) the link to the Section 108 loan guarantee program to get to scale is viewed as a deterrent.

Brownfield remediation is expensive and difficult to accomplish under current HUD rules. Above we mentioned that such remediation should be eligible under CDBG rules. However, we assert that this is a substantial problem, going beyond the scope of one agency, and should be the subject of a joint HUD-EDA grant program modeled after Clean Ohio’s brownfield revitalization and assistance programs, with similar rules for fund allocation.⁵⁵ We suggest that both brown- and greyfields be tackled and that land-banking be encouraged. Economic regeneration can take anywhere from 10 to 20 years, but it cannot begin without a stock of available land.

We understand why requirements against land-banking are in place in an era with scarce resources. We understand that providing incentives to cities to take over failed properties can be the gateway to corruption and pettifoggery behavior at worst and overpayment at best. However, in cities that are experiencing population loss and that have a surplus of housing and seriously degraded land uses, land-banking and land remediation are necessary preconditions for recovery and revitalization.

These negative comments are intended as an assessment of CDBG’s utility as an economic development program. They are not intended to denigrate the importance of CDBGs as a source of revenue for core communities and cities with large low-income populations. As one of our working group members wrote: “[CDBG] money is still being used for community development purposes by and large but mostly for a bunch of projects, not much connected to a strategy, and mostly driven by councilmanic pressures. In most cities, if CDBG were to disappear, most all of the things funded would **NOT** be funded with local funds, [which is] the key tip off that these funds aren’t displacing local funds.”

As such, we have a number of recommendations for revamping the CDBG program:

- HUD must undertake a serious review of the rules that have accreted around its programs.

⁵⁴ Brownfields Economic Development Initiative (BEDI) <http://hud.gov/offices/cpd/economicdevelopment/programs/bedi/>

⁵⁵ The rules are on the program’s Web site http://clean.ohio.gov/BrownfieldRevitalization/Documents/CORF_Round6_Final.pdf and http://clean.ohio.gov/BrownfieldRevitalization/Documents/FinalCOAFPolicies_12082008.pdf

- Any economic development block grant requirements should focus on linking low- and moderate-income individuals to work. If current requirements to spend CDBG funds in low-income and moderate-income neighborhoods were applied to an economic development block grant, the funds would be ineffective.
- The Section 108 loan guarantee program does not work. The need is for transformative investment in land. This will involve land-banking, tackling both brownfields and greyfields, and leveraging federal, state, and local funds.
- Planning money is required to make any economic development block grant effective, as are multiyear funding commitments.

Recommendation 3: Fiscal restructuring of failed cities.⁵⁶

Federal, state, and local governments can help reconnect distressed central cities to their regional economies, but only as long as there is sufficient political will to do so. The proposals offered here are so disruptive to the redistributive local politics existing today in cities with failed fiscal systems that initially they will be adopted by cities only in response to a severe municipal crisis.

Hill and Nowak proposed a voluntary three-part mechanism for reconnecting distressed central cities to their regional economies:

- Long-term restructuring and lowering of municipal taxes.
- Careful examining and strengthening of public administration and management.
- Developing procedures and funding for the assembly of land and renewal of infrastructure.

Together, federal, state, and city governments can craft a package of reforms that immediately benefit severely distressed urban municipalities. This reform package would create an economic environment that supports private-sector productivity and, through productivity enhancement, creates jobs. The mechanism for change requires a combination of tax cuts, public-sector managerial reforms, and new financing for land assembly.

Distressed cities cannot undertake these reforms on their own. They need both political and fiscal freedom to change the usual way city business is conducted. Meaningful reform will take place only with the aid of a powerful outside agent, working with a tough operating agreement, that will give local politicians someone else to blame for the necessary, painful restructuring. The federal government's major role is to make up for revenue shortfalls over a 10-year period, as cities radically reduce their tax rates to create an environment in which they can re-establish the value of their assets and assure a competitive future.

The effort must be led and coordinated by the domestic equivalent of the International Monetary Fund. Wherever it is located, the agency must be able to execute a rigorous operating agreement with the participating city and its state government. The agreement must have clear sanctions, including an end to federal participation in the city's fiscal reorganization if the city or state does not fulfill its commitments.

Step One: Reforming the Tax Structure

The rescue effort begins with radical municipal tax reform, with the federal and state governments making up for revenue shortfalls for 10 years. That 10-year window gives tax reform a chance to succeed and gives the private sector a chance to grow. It also allows the city to make staffing reforms without having to ask public employees to bear the entire burden of reconnecting the city to its regional economy.

Real estate developers and businesses will not respond immediately to tax reform, even if tax rates are radically lowered. Time is needed to assemble, clear, and retitle an inventory of marketable land. Businesses will need time to understand, and believe, the changes that are taking place, especially in the way cities are administered. The increase in local tax revenue triggered by the full package of reforms is not likely to be evident for three to five years.

⁵⁶ Adapted from Edward W. Hill & Jeremy Nowak, "Nothing left to lose: Only radical strategies can help America's most distressed cities." *Brookings Review* (Summer, 2000). Available: http://www.brookings.edu/articles/2000/summer_cities_hill.aspx

Step Two: Reforming Public Administration

A management improvement task force should review city operations to learn which municipal products and services are genuinely necessary. The task force should also compare overall city staffing levels with those of other, similar-sized cities. Not all struggling cities have too many workers. Many cities face the problem that their workforce is too small and, after years of fiscal bloodletting, instability, and penury, is lacking in competent senior-level management. All distressed cities have dispirited, ineffective workforces, reflecting years of neglect in training, capital, and leadership.

After the task force identifies managerial holes in a city's bureaucracy, the state must make a commitment to fill them. Because the environment in the municipal workforce is often too risky to attract any but the most daring public professionals, the state may have to lend executives to the city for an extended period or allow newly hired professionals to move into the state's civil service system.

The task force should also analyze management practices, document the capital equipment required by the work force, and describe the skills and training required to carry out tasks. Employees and their unions should be included in these reviews, for they know more about how their jobs are, and can be, performed than anyone else. Few workers want to come to work and do a terrible job.

Another administrative issue is possible public-sector corruption. Often, what appears to be corruption is in fact incompetence, or the reaction to it, as people try to get around a dysfunctional bureaucracy. But corruption can be real and can result from the breakdown of fiscal controls and inattention to or disruption of day-to-day management. The task force itself should address managerial breakdowns. A vigorous audit of city operations should deal with financial controls and corruption. Prosecutions, if required, should not drag on forever. Petty corruption should be handled administratively to allow city business to resume as quickly as possible.

Step Three: Banking and Assembling Land and Renewing Infrastructure

Distressed cities have collections of abandoned land that are liabilities, while newer suburbs have inventories of vacant land that are assets. To regain their competitiveness with outlying areas, which have only to clear and develop former farmlands, cities need to take title to abandoned urban properties, clear and assemble them into marketable parcels, and do so without lengthy and expensive court procedures.

This proposal is offered as the basis for a voluntary experiment with a new partnership between city, state, and federal governments. Fixing the real competitive disadvantages of distressed cities, outdated tax structures, broken political cultures, uncompetitive staffing levels, vacant and abandoned land, and an inappropriate array of public services will require radical experimentation and state and federal support. Cities cannot address their competitive disadvantages on their own. State and federal governments have to become partners with them in reform. That partnership cannot be based on old entitlement and categorical models of federal and state aid.

For too many cities, there is little left to lose and little time to spare. There is no use for cities with dysfunctional economies, and people will vote with their feet. Neighborhood and community development investments will fail if cities are not fiscally viable. Opportunity cannot take root in places that are disconnected from the world of work.

Too long seen as a drain on resources, lacking in hope and opportunity, and bearing all responsibility for their failings, urban America is right to hope for and expect change from the new administration. The new President and his administration must be positioned to make good on his promise to "rebuild and renew" the nation's urban core as economically robust places to live and work. Restoring vitality to America's cities will require reinvigorating HUD, renewing emphasis on urban development, and restructuring inflexible, isolated programs that fail to meet the complex needs of today's distressed urban areas. The strategies presented here recommend a broadened focus for HUD and a broader understanding of the many roles to play in crafting an effective and transformative economic development vision and action plan for America's cities.

CHAPTER 8

ANCHOR INSTITUTIONS AS PARTNERS IN BUILDING SUCCESSFUL COMMUNITIES AND LOCAL ECONOMIES

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

EXECUTIVE SUMMARY

The U.S. Department of Housing and Urban Development (HUD) is the key Federal agency charged with improving the quality of life in urban America. One new paradigm that HUD should advance for urban revitalization is through strategies that engage urban anchor institutions, particularly institutions of higher education and academic medical centers (“Eds and Meds”), in collaborative partnerships with Federal, state, and local government, other agencies, schools, civic leadership, and local communities. Large job-generating industries have left many cities. What remains is the vibrant, but yet to be fully tapped resources of the knowledge economy being led by Eds and Meds rooted in their local communities and regions.

This report outlines a new role for HUD, serving as a facilitator and catalyst (inter-governmental at the Federal, state and local levels, and with local, city and regional institutions) for comprehensive anchor institution-community collaborations in cities and metropolitan regions, focused on housing, economic and community development, healthcare, schools, and culture. With HUD leadership, the Federal Government can help catalyze, create, and sustain new forms of partnerships involving Eds and Meds and other anchors.

The Task Force believes the core argument for HUD’s leadership in pursuing this new paradigm can be summarized by the following five points:

1. Anchors, particularly Eds and Meds, are key to the revitalization of many of America’s communities, cities, and metropolitan areas.
2. When the entire university is engaged, including all its resources – human, academic, cultural, and economic – enormous progress can be made in improving the communities in which they are located.
3. The Federal Government can and should play a catalytic role in engaging anchor institutions in democratic partnerships with their communities, cities, and regions.
4. HUD as the agency responsible for urban areas and place-based development should take the lead.
5. Given the importance of anchors, particularly Eds and Meds, to the revitalization of communities and cities, the role and significance of the Office of University Partnerships (OUP) should be substantially increased by elevating the status of its function within HUD.

Certainly, much has been accomplished since the inception of the OUP and its various funded programs, such as its notable Community Outreach Partnership Centers (COPC). More can and should be done, however. When an entire university – i.e. its corporate as well as its academic side – is engaged, it can be a catalyst to transform communities. The goal the Task Force urges HUD to accomplish is to help universities and other anchor institutions engage their full set of resources – human, academic, cultural, economic – with their community, forging democratic, mutually beneficial, mutually respectful partnerships. In doing so, HUD will simultaneously help stimulate the cultural and organizational changes needed within colleges and universities to embed and sustain civic engagement across all components of the institution, which will result in the increased contributions of universities to the quality of life for residents of America’s cities and metro areas.

INTRODUCTION

Deindustrialization and globalization have undermined the traditional manufacturing-based economies in many American cities and metropolitan areas, leaving unemployment, poor schooling and generational poverty in their place. A knowledge-based economy is now dominant in these areas. New institutions have stepped forward as the “anchors” of their communities, particularly institutions of higher education and academic medical centers – “Eds and Meds.” Universities and academic medical centers are referred to throughout this report as “anchor institutions” because these institutions, “by reason of mission, invested capital, or relationships to customers or employees, are geographically tied to a certain location.”⁵⁷ As such, they have a strong economic stake in the health of their surrounding communities and – due to the scale and scope of their operations (over seven million employees and \$1 trillion in annual economic activity) – the resources to make a genuine difference. (Note: For purposes of this report, university is used as a term that encompasses all types of institutions of higher education.)

There is also a growing recognition that the future of Eds and Meds is intertwined with their communities and cities. Eds and Meds are place-based institutions which, given their vested interest in their geographical communities and their sizeable real estate holdings and local investment, would find it difficult and costly to move. Therefore, today, Eds and Meds are playing a crucial role in the economic vitality and competitiveness of their cities and surrounding regions. They have become increasingly more strategic in leveraging assets, partnering with the private sector, and generally supporting broader community and economic development activities. Across the country, many Eds and Meds are the largest employers in their cities and also fuel local economies through construction dollars and the purchase of goods and services. They also attract a highly educated workforce and offer cultural and other amenities (theaters, museums, academic and other noncredit classes) for the city or region.

Eds and Meds have also come to an increasing recognition that by helping to solve real-world problems – problems that are universal but manifested locally (substandard housing, inadequate healthcare, unequal schooling) – they can advance their core missions of research, teaching and service. Moreover, in the opening decade of the 21st century, universities are widely regarded as the most influential institution in advanced societies. They possess enormous resources (most significantly human resources), play a leading role in developing and transmitting new discoveries and educating societal leaders, and basically shape the schooling system.⁵⁸

With HUD and the Federal Government utilizing both financial incentives and the bully pulpit, colleges and universities have the potential to fulfill their stated – but not fully realized – mission of service to society. This mission has considerable historical grounding: the founding purpose of both colonial colleges and Historically Black Colleges and Universities was to educate young people for service to others. Fulfilling America’s democratic mission was the founding purpose of land-grant universities. A defined urban-serving mission for higher education dates from the late 19th century and the founding of Johns Hopkins University, the first modern university, in 1876. William Rainey Harper, the first president of the University of Chicago, was the most eloquent and powerful proponent for the engagement of universities with their cities and communities. He helped the University of Chicago become perhaps the greatest university at the turn of the last century by acting on the premise that involvement with the city, particularly its schools, would powerfully advance faculty research and student learning. The idea that universities can and should play a central role in improving urban life motivated Julian Levy’s work at the University of Chicago in the 1950s and 60s, which is a source of some of the ideas and approaches developed and implemented over the past 15 years.

The idea that universities have the potential to be powerful resources for solving highly complex urban problems is also longstanding, inspiring both Paul Ylvisaker’s speech in 1958, calling for the development of urban experiment stations modeled after the work of agricultural land grants, and Robert Wood’s plan for Urban Observatories. Thus far, this compelling idea has not been fully realized. Under the leadership of John Gardner, the U.S. Department of Health, Education, and Welfare provided hundreds of millions of dollars, as did the Ford Foundation, to universities

⁵⁷ Henry Webber and Mikael Karlstrom, “Why Community Investment is Good for Nonprofit Anchor Institutions: Understanding Costs, Benefits, and the Range of Strategic Options,” Annie E. Casey Foundation, July 21, 2008, p. 1

⁵⁸ Derek Bok, *Universities and the Future of America*, Durham, NC: Duke University Press, 1990; Ernest L. Boyer, “Creating the New American College,” *Chronicle of Higher Education*, March 9, 1994, p. A48; John W. Gardner, “Remarks to the Campus Compact Strategic Planning Committee,” San Francisco, February 10, 1998; Alexander W. Astin, “Liberal Education and Democracy: The Case for Pragmatism” in Orrill, *Education and Democracy*, pp. 207–23

to develop projects and programs with their cities and communities. Unfortunately, these funds did not produce the desired result. Treating urban engagement as a mere add-on, colleges and universities applied little, if any, effort to changing their core teaching and research functions. They resisted making the internal changes needed to work effectively with government, foundations, and other organizations and contribute to the improvement of their local communities and cities. The crisis of the American city also had not yet caught up to urban universities.

By the 1990s, however, universities were increasingly unable to avoid the problems of their local ecological communities, including crime, violence, and physical deterioration. A compelling intellectual case (developed in the 1990s by Derek Bok, Ernest Boyer, and John Gardner, among others) for university engagement began to have a powerful impact on a number of faculty and some college and university presidents. That argument, simply stated, is that universities, particularly urban universities, would better fulfill their core academic functions, including advancing knowledge and learning, if they focused on improving conditions in their cities and local communities. When Secretary of HUD Henry Cisneros created the Office of University Partnerships in 1994, he explicitly emphasized that universities were a crucial resource for improving America's cities and that universities would significantly benefit from serious engagement with the problems of their environment. The abstract from his 1995 essay "The University and the Urban Challenge" summarizes these arguments as follows:

Because of their concern for security, sense of responsibility as publicly supported institutions, and programs for service-learning, many universities are closely linked to their urban communities and have much to offer these centers. American colleges and universities possess a wealth of intellectual and economic resources that they can bring to bear on the problems of cities. John Dewey's beliefs that school and society are one and that real advances in knowledge occur by means of a focus on the central problems of society are now widely accepted in academic circles. Colleges and universities are also important economic entities generating jobs and taxes in their communities and growing as local and regional centers of economic development. Many colleges and universities are helping revitalize their local neighborhoods and communities. In response, the Department of Housing and Urban Development established the Office of University Partnerships in July 1994 which will offer institutions of higher education the following grant programs for community-building activities: Community Outreach Partnership Centers, Historically Black Colleges and Universities, Joint Community Development Program, Doctoral Dissertation Research Grants, and Community Development Work Study.⁵⁹

Fifteen years after the creation of OUP, institutions of higher education are more likely than ever to respond to a renewed partnership with HUD to engage with their local communities, cities and metropolitan regions. They are under increased scrutiny by government to demonstrate that they are serving the public good, as evidenced, for example, by Senator Grassley's hearing on university endowments. "Community benefit" is also becoming the sine qua non of funding appeals to donors, foundations, as well as governmental agencies. Higher education understands more fully that it is in its enlightened self-interest to be civically engaged.

Successful approaches to community revitalization require that government contribute to collective capacity building among the multiple partners, including institutions and community members. Such policies need to target anchor institutions as leaders in generating and guiding urban and metro area revitalization – offering not only new local initiatives, but also new and creative ways for the Federal Government to play a collaborative role. In this approach, the Federal Government functions as a collaborating partner, effectively facilitating cooperation among all sectors of society, serving as a powerful catalyst and providing the funds needed to create stable, ongoing, effective partnerships. This strategy also requires creatively and intelligently adapting the work and resources of a wide variety of local institutions (higher eds, hospitals, faith-based organizations) to the particular needs and resources of local communities.

Universities and colleges, which simultaneously constitute preeminent international, national, and local institutions, potentially represent by far the most powerful partners, "anchors," and creative catalysts for change and improvement in the quality of life in American cities and communities. For universities and colleges to fulfill their great potential and more effectively contribute to positive change in their communities, cities, and metropolitan areas, however, they will have to critically examine and change their organizational cultures and structures and embed civic engagement across all components of the institution. The Federal Government, led by HUD, can stimulate that examination and change.

⁵⁹ Henry G. Cisneros, *The University and the Urban Challenge*, Washington, D.C.: U.S. Dept. of Housing and Urban Development, Feb. 1995

This Task Force proposes a multifaceted, comprehensive involvement of universities and other anchors in America's cities and metropolitan areas, including spurring and supporting community and economic development, convening public discussions, educating public-spirited leaders, offering continuing civic and leadership seminars, and providing a wide range of technical assistance. The approach proposed here requires much more than practicing new forms of interaction among Federal, state, and local governments and among agencies at each level of government; it also is consistent with President Obama's vision of a "catalytic government" and calls for new forms of interaction among the public, for-profit, and nonprofit sectors. We propose that HUD take the lead in effectively facilitating cooperation among all sectors of society, including higher educational institutions, to support and strengthen our communities, cities, and metropolitan regions.

The strategies and recommendations presented in this document are designed to help achieve key goals detailed in President Obama's urban policy, including:

1. Strengthening the Federal commitment to American cities;
2. Stimulating economic prosperity in metropolitan areas; and
3. Making housing more affordable.

Furthermore, throughout his campaign, President Obama called for a "New Era of Service." The President's inspiring challenge to serve applies not only to students, but to institutions as well. Eds and Meds, as well as anchor institutions in general, have a powerful opportunity to increase their contribution to the public good.

Now is an opportune moment to create a new compact between government, anchor institutions and their communities. It is appropriate that HUD, as the Federal agency concerned with urban communities and issues of place, take the lead in engaging the full range of intellectual, human, economic, cultural, and other resources of anchors to improve the quality of our cities. HUD can also take the leading role in promoting inter-agency cooperation at the Federal level, as well as with and among state and local governments.

This report explores the multi-faceted roles that anchors, particularly Eds and Meds, play in cities and metropolitan regions (education, research, service, housing and real estate development, employment, job training, purchasing, hiring, business incubation, and cultural development) and offers recommendations designed to realize HUD's goals of increasing home ownership and affordable housing and strengthening the economic, social and civic health of the nation's communities. The report also challenges HUD to hold Eds and Meds accountable by insisting that they be rewarded with Federal support to undertake these activities only if they follow the "Noah Principle" – funding given for building arks (producing real change), not for predicting rain (describing the problems that exist and will develop if actions are not taken). Funded activities should further demonstrate community benefit, not simply benefit to the university, as well as transparent and democratic collaborations with local partners. Finally, there needs to be accountability for results that are measurable and sustainable.

The strategies recommended in the report would have the following impacts:

1. An increased contribution by Eds and Meds and other anchors to the quality of life and learning in their communities, as well as society in general.
2. Stronger, more globally competitive cities and metropolitan regions.
3. Substantial improvement in the quality of life for all residents of America's cities and metropolitan areas.
4. A more democratic, humane, and just society.

STRATEGIC PREMISES OR BACKGROUND STATEMENT

These recommendations are made based on the following general premises:

1. Eds and Meds, as well as other anchors, are important resources in cities and metropolitan areas and key to their development and improvement. Simply put, the serious, significant, sustained engagement of Eds and Meds with their communities, cities and metro areas can be a major force for positive change. Anchors, in effect, need to be active institutions in their local environment for their own benefit and that of cities and communities. The future of Eds and Meds, and anchors in general, and their cities and communities are intertwined.

2. Eds and Meds are inherently place-based institutions, which have local/regional and national impacts and outreach.
3. Eds and Meds can advance their core academic and service missions through significant engagement with their communities, cities, and metropolitan areas.
4. Higher educational and medical consortia can have powerful impacts on improving the quality of life and learning in cities and regions.
5. Progress has been made engaging Eds and Meds with their cities and communities, but a good deal more can and should be done.
6. Comprehensive involvement of all the resources of Eds and Meds are required if significant progress is to be made. A primary goal should be to engage the university's resources fully – human, cultural, academic, economic – with its community in democratic, mutually beneficial, mutually respectful partnerships.
7. As comprehensively engaged civic institutions, Eds and Meds will make significant contributions to their environments, communities, and cities. They will also be able to work with their communities to help solve the most significant problems of our time as they are manifested locally: substandard housing, community deterioration, inadequate schools, and poor health care. By confronting and working to solve these problems as they are manifested locally, universities, in particular, will make even greater contributions to learning and research. Among other things, creative, sustained interschool and interdisciplinary collaboration will be promoted in the process of working to find solutions to highly complex community-identified problems.
8. Eds and Meds should not work in isolation, but through partnerships with local communities, agencies and state and local government, as well as through regional consortia.
9. Partnerships should be democratic in purpose, process and impact.
10. The Federal Government, led by HUD, has a central role to play in catalyzing and facilitating effective democratic partnerships between Eds and Meds and the communities and cities of which they are a part.

The above premises are based on convincing evidence of the major impacts Eds and Meds have in their local communities and regions. These impacts could be multiplied many-fold if the resources of Eds and Meds were effectively channeled in partnership with a revitalized Office of University Partnerships.

A. Immediate Actions and Strategic Summary

By significantly expanding HUD's current efforts of encouraging university-community engagement through community outreach partnerships centers, institutional capacity-building grants, early career research grants, urban university grant programs, housing development and assistance, economic and community development programs, and regional collaborations, Eds and Meds will be a fuller and more significant force for positive change in their communities, cities, and metro areas.

Given the severe economic crisis facing our nation, the Task Force is mindful of both the need for urgent action and constraints on funding. We, therefore, propose eight immediate actions for HUD to take. These steps lay the foundation for the full development of HUD's work with Eds and Meds and other anchor institutions. The list of immediate actions is followed by an outline of three broad strategies for HUD to pursue, as well as the Task Force's specific short-term and long-term recommendations under each strategy. These recommendations reflect the Task Force's best thinking as to how HUD can effectively work with and engage Eds and Meds and other anchor institutions for the benefit of communities, cities, and metro areas.

1. Immediate Actions

The Office of University Partnerships needs to be more visible and have a higher profile within HUD. Reinvigorating OUP and its role within the Department will enable HUD to define and implement the recommendations that the Task Force outlines. Actions include:

1. Designate a Deputy Assistant Secretary for Higher Education and Anchor Institutions.
2. Name a director for OUP from the academic community.
3. Fund the Community Outreach Partnership Centers Program, with two funding allocations: Phase One—new applicants, and Phase Two—five-year funding for institutions that are poised to take on or advance their role as “fully engaged” anchor institutions.

4. Restore support and increase funding for all current OUP component programs.
5. Establish an Anchor Institutions Program Division to house programs that leverage anchor institutions' economic assets for community economic development.
6. Create staff positions in the HUD Regional and Local Offices on OUP issues.
7. Institute Secretary's Awards that recognize outstanding local and regional partnerships, as well as significant urban problem-solving research.
8. Host a White House Summit on Eds and Meds and Civic Responsibility.

With these immediate steps in place, HUD would be prepared to begin implementation of the range of strategies that the Task Force outlines in this report.

2. *Strategies*

The Task Force recommends three broad strategies:

Strategy 1 – Enhance the current Office of University Partnerships.

Recommendation 1: Reinvalidate OUP and all its programs.

Recommendation 2: Elevate the status of the OUP within HUD.

Recommendation 3: Create an Anchor Institution Program Division within the Office of University Partnerships whose role is to assist universities, medical centers, hospitals, cultural institutions and other place-based anchors to leverage their economic power for community benefit.

Recommendation 4: Implement new programs to strengthen and expand the Office of University Partnerships.

Strategy 2 – Promote affordable housing through intra-HUD collaboration with anchors, particularly Eds and Meds.

Recommendation 5: Within the HUD Office of University Partnerships create an Anchor Institution Housing Development Program with an explicit focus on meeting HUD housing development objectives.

Recommendation 6: Launch a Nonprofits House America program that is awarded competitively through a grant process and provides a match of up to 50 cents for each dollar of housing subsidy.

Recommendation 7: Launch a Universities Serving America program to encourage their students to participate in service.

Recommendation 8: Launch a Housing Information Systems grant program to support the development of university-based information resources that can assist community groups in developing strategies to respond to such issues as foreclosure prevention and mitigation, emergency preparedness response, and building deterioration.

Strategy 3 – Promote community and economic development through intergovernmental collaboration led by HUD in partnership with anchors, particularly Eds and Meds.

Recommendation 9: Create programs focused on economic development, workforce development, health, education, culture, and regional development.

STRATEGY 1 – Enhance the Current Office of University Partnerships

A. Short-term Recommendations

Recommendation 1: Reinvalidate the Office of University Partnerships.

The strategy proposed here requires creatively and intelligently adapting the work and resources of a wide variety of local institutions (e.g., higher eds, hospitals, faith-based organizations) to the particular needs and resources of local communities. It assumes, however, that universities and colleges, which simultaneously constitute preeminent international, national, and local institutions, potentially represent by far the most powerful partners, “anchors,” and creative catalysts for change and improvement in the quality of life in American cities and communities.

To create such new Federal-state-local collaboration around urban anchor institutions, we recommend that the HUD Secretary work with the White House and the Office of Management and Budget (OMB) to reauthorize the *Housing and Community Development Act of 1992* to expand funding for the existing programs of HUD's Office of University

Partnerships, particularly Community Outreach Partnership Centers, as well as establish new OUP initiatives that extend HUD's role as a catalyst for democratically engaged universities.

Recommendation 2: Elevate the status and role of the Office of Urban Partnerships within HUD.

The Task Force chaired by Hal Wolman on HUD's role in regional affairs has recommended that the current position of Assistant Secretary for Community Planning and Development be modified to become the Assistant Secretary for Urban, Regional and Community Development, giving that section of HUD the clear mandate to tackle the place-oriented issues at the regional, city, and community level. The Anchor Task Force recommends that if this recommendation is implemented, a Deputy Assistant Secretary for Higher Education and Anchor Institutions be created with the mandate, authority, and budget to provide the leadership for the programs and initiatives recommended below.

Strengthening of OUP would obviously be a core function of this Deputy Assistant Secretary: university research, teaching, and service functions, as well as economic functions of Eds and Meds, and other anchors would all be areas of focus and support. This Office would be the link to integrate higher educational institutions with all divisions within HUD and across other Federal departments on urban-focused issues. All university engagement would be the responsibility of this Office. It would also include engaging Eds and Meds with larger economic and community revitalization approaches – those that require the involvement of other agencies. OUP would function as the core agency promoting effective democratic devolution, involving the coordination and collaboration of Federal agencies to engage anchors (primarily Eds and Meds) with their local communities.

Recommendation 2.1: Create staff positions in the HUD Regional and Local Offices on OUP issues. The driving down of functions and funds to the local level also requires the coordination and collaboration across state and local agencies and the connection of those agencies with Federal agencies. In this case, the HUD Regional Offices should take the lead role at the local level in coordinating and helping to support local coalitions of Eds and Meds, other anchors, schools, and community organizations. HUD, as the agency concerned with the city- and place-based approaches would function as the lead catalyst for “a university-assisted democratic devolution revolution” – an approach in which the Federal Government provides sufficient leadership and funds and taps and galvanizes local institutional and community resources, while holding local partners accountable for performance.

Recommendation 2.2: Reauthorize the Community Outreach Partnerships Centers [COPC] program at the Department of Housing and Urban Development's Office of University Partnerships. The Task Force proposes that the HUD Secretary lead the discussion with the Administration to reauthorize and significantly expand the funding level of the Community Outreach Partnership Centers program. We recommend that the purpose of this program be clarified to emphasize mutually beneficial partnerships between urban institutions of higher education and their local communities (including other anchor institutions) and by aligning teaching, research, and service with the needs and expectations of community members.

The COPC program should have two funding initiatives:

- (1) Three-year funding for institutions that have established a beginning track record at working at the neighborhood level and that will advance this work [Phase 1]; and
- (2) Five-year funding for institutions that are poised to take on or advance their role as “fully engaged” anchor institutions: working on multiple issues, such as housing, economic development, employment, education, and culture, that involve the corporate as well as academic sides of the university, including the significant commitment of senior leadership [Phase 2].

This program would involve the variety of institutions of higher education which act as anchors in their local communities: community colleges, research universities, Historically Black Colleges and Universities, private and public colleges, and Alaska Native/Native Hawaiian, Tribal, and Hispanic-Serving Institutions.

This program should include, as should all HUD university-based programs, requirements for financial contributions from within the university to sustain and complement grant funding. Requirements would begin at a more modest level and escalate over time, to encourage the sustainability of the activities beyond the grant period.

This program should establish, as should all HUD university-based programs, new criteria for funding. Universities need to be judged by new criteria if they are truly acting as anchors for community revitalization. HUD needs to adopt the “Noah Principle” – funding given for building arks (producing real change), not for predicting rain (describing the problems that exist and will develop if actions are not taken). Universities should also be judged on whether they are building the work into the academic core of the institution. Other determinants of support should be whether all the components of the institution are engaged, whether the work is being done democratically, and whether partnerships are being created and sustained.

Recommendation 2.3: Fully fund and further develop OUP’s other component programs. OUP has supported the training of professionals in community development, including graduate students committed to urban research, who are essential for advancing and sustaining the field in the future. OUP has also supported targeted funding for higher educational institutions that serve particular constituencies. These institutions, with unique histories and missions, bring diverse and valuable perspectives to this work and include communities that are often underserved. These programs include the Community Development Work Study Program (CDWSP); Doctoral Dissertation Research Grants (DDRG); Early Doctoral Student Research Grants (EDSRG); and minority-focused initiatives, including Alaska Native/Native Hawaiian and Hispanic-Serving Institutions Assisting Communities, Historically Black Colleges and Universities, and Tribal Colleges and Universities. The Universities Rebuilding America Partnership, which offers resources and support to engage college and university students, faculty and staff in helping rebuild the Gulf Coast region, has also established an excellent track record and should be continued.

Recommendation 2.4: Reinstitute a director of OUP, working under the new Deputy Assistant Secretary, from the academic community. The selected individual would be assigned an Interagency Personnel Agreement (IPA), which provides the opportunity for faculty members to work for the Federal Government on special assignment. The OUP Director assignment would require a contract between the university and HUD, releasing the faculty member for one or two years from his or her regular university duties.

Recommendation 2.5: Call for a White House Summit on Eds and Meds and Civic Responsibility. The Secretary of HUD could take the lead in forging a multi-agency Federal commission to advance the civic responsibility of Eds and Meds. This commission could produce recommendations that would serve as the basis for a National Summit or White House Conference on the Civic Responsibility of Higher Eds and Meds that could help spur both a national conversation and appropriate action at all governmental levels.

Recommendation 2.6: Institute Secretary’s Awards that recognize outstanding local and regional partnerships, as well as significant urban problem-solving research. Awards for partnerships would be given to universities and their community and/or school partners that make significant, sustained contributions to improving the quality of life in the community and the quality of research, teaching and service on campus. Awards for research would be given to faculty that make a contribution to improving the quality of life in a university’s local ecological community, as well as to advancing knowledge that can be effectively adapted to other communities, cities, and regions.

Recommendation 3: Create an Anchor Institution Program Division within the Office of University Partnerships whose role is to assist universities, medical centers, hospitals, cultural institutions and other place-based anchors to leverage their economic power for community benefit. This program division would convene a multi-stakeholder group, an Integrated Community Anchor Network, to support cross-anchor institution collaborative efforts on a regional basis. Additionally, the Anchor Institution Program Division (whose programs are described below in the economic and community development section) would oversee seed grants to facilitate the leveraging of anchor institution economic assets (purchasing, investment, hiring, business incubator, etc.) for community development, a grant pool to supply loans or matching capital for state and local efforts, and funding for campus-based community economic development centers. As the programs in economic and community development are established, HUD should consider a direct report to the Deputy Assistant Secretary for this program division.

B. Long-Term Recommendations

Recommendation 4: Develop new programs to strengthen and expand the Office of University Partnerships.

Recommendation 4.1: Designate urban universities as leaders in community engagement that are eligible for special Federal funds. Selected universities, colleges, and community colleges should receive Federal support for graduate fellowships and special projects and activities. The national Urban Grant University program would be modeled after the Land, Sea, Space, and Sun Grant programs. To be selected as an urban grant university, a public or private urban university, college, or community college must be recognized for excellence in fields related to the mission of HUD and demonstrate a record of long-term and institution-wide commitment to community engagement.

Recommendation 4.2: Support K-20 education and professional education to promote (1) leadership in the community development field; and (2) public schools as core institutions for community revitalization. This effort requires recognition of the critical and essential role that high-quality K-12 schools play in sustaining vibrant, healthy cities. Moreover, the transformation of higher education – the most influential, strategic, powerful component of the schooling system – is crucial to the transformation of the entire schooling system and the education of democratic creative, caring, contributing democratic citizens. HUD could invest in K-20 collaborations that would create an integrated high school/community development focused curriculum, which, among other things, would help create an educational pipeline for community development professionals. This type of curriculum would engage young people in secondary and higher education to learn by studying issues and problems in their own communities, proposing and then implementing solutions. HUD regional offices could provide expertise to assist in the development of this curriculum. Moreover, HUD could help create a pipeline of researchers and practitioners in the community development field. The specific recommendations are outlined in the education section found under strategy 3.

Recommendation 4.3: Institute a Problem-Solving Urban Research Grant Program. HUD can build on more than a decade of experience in problem-solving urban research, promote promising practices, and create supports and incentives for institutions to work on urban and regional issues with local partners.

The specific Urban Research Grant recommendations are:

- Establish a new competitive grant program for early career researchers to conduct research in fields relevant to the mission of HUD. This type of engaged scholarship requires support for academically relevant faculty work that meets both the campus mission and community needs. The program should be modeled after the National Science Foundation's successful early career research grant program, which provides \$80 million per year to support five-year project grants to individuals who have received a doctorate degree within the last decade and are employed in a tenure track (or tenure-track equivalent) position.⁶⁰
- Create a training and award program to encourage the development of new Neighborhood Indicators Projects based in universities. The National Neighborhood Indicators Partnership, based at the Urban Institute, has among its local affiliates many university research centers that are pivotal for community building in their home cities, providing the neighborhood-level data that HUD, anchor institutions, and community groups need to more effectively target their resources. To date, such efforts exist in about 40 U.S. cities.⁶¹ HUD, through OUP, can support the development and expansion of these programs, helping to build HUD's own ability and that of anchor institutions to measure their community impact and thus improve the quality of their work.
- HUD, under the direction of the new Deputy Assistant Secretary, should connect to the recent developments at the National Science Foundation (NSF)/National Institutes of Health (NIH) around community impacts and community engagement in research. HUD could help investigators to connect their work to ongoing projects that are making a difference in the quality of life and the quality of education of young people in the university's local ecological community. This program would help investigators to effectively meet both NSF's requirement that proposals illustrate how proposed research

⁶⁰ National Science Foundation, Faculty Early Career Development (CAREER) Program: Program Solicitation 08-557, Arlington, VA: NSF, 2008, <http://www.nsf.gov/pubs/2008/nsf08557/nsf08557.htm>, accessed Jan. 11, 2009

⁶¹ G. Thomas Kingsley and Kathryn L.S. Pettitt, *Neighborhood Information Systems: We Need a Broader Effort to Build Local Capacity*, Washington, D.C.: The Urban Institute, October 12, 2004, www.urban.org/url.cfm?ID=900755, accessed January 10, 2009

will result in “broadening participation” and “broadening impacts” and NIH’s requirement for “community inclusion” in many center grants and for community-based participatory research proposals.

- Create a regularly occurring national forum for practitioners of problem-solving urban research, involving both the university-based analysts and their partners in local government and community organizations. Forums would focus on sharing lessons and improving practice. Documents and training materials for the field would be produced as an outcome of the forums.

Recommendation 4.4: Establish an independent advisory council to advise the Secretary of HUD regarding oversight and evaluation of the various university partnerships programs. The council shall consist of approximately 15 members, including representatives from institutions of higher education, state and local governments, community organizations or non-profits, and the private sector. The University Partnerships Advisory Council would review, comment and recommend directions for the Department’s urban research, monitoring and evaluation, providing a complementary perspective to that of peer researchers and national policy leaders.

Recommendation 4.5: Create a consultation team comprised of faculty and staff from institutions that have been successful in their work with the community to aid in training and technical assistance. The first level would be to identify benchmark institutions in “university community competence” – that is, universities that have taken the time to create a culture among their faculty and students – that effectively listen, research with, and engage their communities. Those institutions would serve as the consultants to other universities and communities in promoting university-community engagement efforts leading to urban revitalization. The second level would be to provide additional seed grants to facilitate campus-community partnerships for urban revitalization for those communities that have demonstrated potential from their work with the consultation teams described above.

STRATEGY 2 – Promote Affordable Housing through Intra-HUD Collaboration with Anchors, Particularly Eds and Meds

A. Anchor Institutions Joining Forces with HUD to Meet the Housing Need

One of the leading assets of anchor institutions is their ownership of land and real estate. Leveraging anchor institutions to support housing goals is an obvious strategy to expand HUD’s housing development work. Many anchor institutions today offer a range of housing services, including a number of programs that assist low and moderate-income employees. A 2007 study by the Lincoln Institute of Land Policy, for instance, identified two-dozen examples of prominent employer-assisted housing programs at a wide range of public and private universities. A number of leading hospitals and health care institutions likewise operate employer-assisted housing programs with direct community revitalization goals. In some cases, anchor institutions have gone beyond support for homeownership counseling and down payment assistance to also support permanent housing affordability by helping finance community land trusts.⁶²

Additionally, universities, in particular, have access to data resources that can be of tremendous value in assisting HUD and communities in reaching affordable housing goals. For instance, through its Community Building Initiative, the University of California, Los Angeles (UCLA) has supported the creation of a citywide organization to use geographic information systems (GIS) mapping to help tenants of rundown apartments improve their living conditions by providing the data they need to identify code violations and gain landlord commitment to invest in buildings and eliminate substandard conditions. The same technology can support many other uses – for instance,

⁶² For instance, the Mayo Clinic in Rochester, Minnesota provided seed funding for a community land trust and helped finance 875 affordable homes; see: First Homes, *History of First Homes*, Rochester, MN: Rochester Area Foundation, 2008, www.firsthomes.org/history.html, accessed August 31, 2008. See also: The University of Illinois at Chicago South Campus development that not only generated over \$600 million of new university and commercial buildings and mixed-use market-rate and affordable housing on site, but generated the city’s largest city-university land agreement and TIF, along with a large scale mix of new HOPE VI-based affordable housing projects with the Chicago Housing Authority; see Perry, Wiewel, and Menendez, *The City, Communities and Universities: 360 Degrees of Development*, Cambridge, MA: The Lincoln Institute of Land Policy, forthcoming.

mapping communities to develop emergency response plans or identifying buildings in danger of foreclosure to enable community groups to respond proactively with foreclosure intervention and mitigation strategies.

Universities also have another key asset in their students. The thousands of students on college campuses can be harnessed for a dramatic impact. Campus Compact, for instance, estimates that the annual value of student volunteer labor now exceeds \$7 billion. These students can be engaged to serve as community organizers, tutors, financial counselors, and so on in our nation's metropolitan neighborhoods. In the education section of this report, we propose creating 2,000 VISTA and AmeriCorps positions through a new Urban Revitalization Corps. But the average VISTA worker, for example, earns \$900 a month – not enough to afford even low-cost rental housing in many areas.⁶³ Already, some regions have created programs to recruit host families willing to offer free or low-cost housing, but these efforts do not exist in all areas and also create potential liability problems.

We recommend that HUD work with anchor institutions to encourage them to expand their housing programs in three areas: (1) to support an expansion of employer-assisted housing as part of larger housing development strategies; (2) to work with anchor institutions to support housing for former students who work for VISTA and AmeriCorps through the (proposed) new Urban Revitalization Corps program; and (3) to support the development of broader technical assistance that can provide information that community groups can use to support their housing development strategies.

B. HUD's Opportunity to Leverage Anchor Institutions for Housing Development

There are a number of striking successes in the area of anchor institutions and housing that HUD should promote: Before closing its doors in 2007, the Fannie Mae Foundation had supported a \$5 million effort to fund university-community partnerships, with a focus on affordable housing development. A program evaluation of 11 sites in 2001 found a high level of success at eight sites. A grant to the University of Michigan, for instance, funded a housing development apprenticeship program. A grant to the University of Alabama, Birmingham funded university homebuyers' counseling services that enabled the university to persuade local banks to develop a mortgage pool that increased housing affordability by providing below-market second mortgages to area residents who had completed university homebuyers' counseling – the first such program in the state. A grant to the Pratt Institute Center for Community and Environmental Development in Brooklyn, New York supplied technical assistance that helped support the development of over 300 affordable housing units in five neighborhoods.

Jackson State University in Mississippi provides an example of a university partnering with a community development corporation to meet local housing needs. Together with a local CDC, the university runs a homeownership program in five local neighborhoods, operates a revolving loan fund to rehabilitate existing homes, and provides opportunities for faculty and students to work with and provide training for neighborhood residents. In April 2005, in partnership with a bank and a local community development corporation, Jackson State launched a new program to support housing in West Jackson for faculty and staff members, as part of its community revitalization efforts.

The University of Texas-Pan American (UTPA) also supports affordable housing and other community development projects. In 1994, UTPA was a first round recipient of a Community Outreach and Partnership Center (COPC) grant. In 1998, backed by a \$500,000 Fannie Mae grant, the Office developed a comprehensive counseling program for Colonia (Latino neighborhood) residents who live in the impoverished rural communities along the Texas-Mexico border. The effort, called "Project HOPE," included new construction and rehabilitation of affordable housing, homeownership training and individual counseling to 117 families, community outreach programs to increase awareness of housing programs, and technical assistance and training for nonprofit housing organizations in Hidalgo County. Although the grant has ended, the university continues to provide first-time homebuyers assistance, as well as other programs such as small business development, technical assistance for non-profit groups and English-language training.

⁶³ As of 2007, the standard AmeriCorps stipend was \$10,900 a year. See: "Nonprofit Minnesota Organization Helps Make Bright Futures Possible for Low-Income Students—with ACT Help," *Activity*, vol. 45, no. 2, www.act.org/activity/spring2007/minnesota.html.

C. Recommendations

The recommendations below aim to leverage HUD dollars as far as possible by deepening and extending current anchor institution-based initiatives, using the following means:

Recommendation 5: Within the HUD Office of University Partnerships, create an Anchor Institution Housing Development Program with an explicit focus on meeting HUD housing development objectives.

This Housing Development Program would serve as an information resource on housing development strategies for anchor institutions that seek to leverage their ownership of real estate to meet housing needs. Additionally, housing program staff should interact with anchor-based programs recommended in this report that have direct housing implications: particularly the Integrated Community Anchor Network, Anchor Builds Community, and Community Economic Development Center programs, as well as relevant research grant programs (such as the HUD Urban Research Grant program, as outlined in the “community partnerships” section of this report).

Recommendation 6: Launch a Nonprofits House America program that is awarded competitively through a grant process and provides a match of up-to-50 cents for each dollar of housing subsidy.

This program would provide a pool of match funding for nonprofit anchor institutions that provide employer-assisted housing benefit for their employees and/or that support the purchase/donation of land into a community land trust to build up a stock of permanently affordable housing. (A maximum of \$1 million per grantee institution would be allotted with funds restricted to households earning 80 percent of area median income or less.)

Recommendation 7: Launch a Universities Serving America program to encourage their students to participate in service.

This program would provide a match of up to 50 cents for each dollar of housing subsidy that an institution of higher education is willing to provide to subsidize housing for former students who are working in the Urban Revitalization Corps, Teach for America, or related AmeriCorps/VISTA programs. In effect, this program should generate enough money (\$7,500 a year each for 10,000 students) to effectively fully subsidize participants’ housing costs, thereby markedly improving the quality of VISTA workers that universities are able to generate to conduct Urban Revitalization Corps, Teach for America, and other AmeriCorps/VISTA service program work.

Recommendation 8: Launch a Housing Information Systems grant program to support the development of university-based information resources that can assist community groups in developing strategies to respond to such issues as foreclosure prevention and mitigation, emergency preparedness response, and building deterioration.

STRATEGY 3 – Promote Community and Economic Development through Interagency Collaboration Led by HUD in Partnership with Anchors, Particularly Eds and Meds

Recommendation 9: Create programs focused on economic development, workforce development, health, education, culture, and regional development.

Urban problems are complex and interrelated and require a multidimensional, comprehensive approach if they are to be solved and conditions improved. The Task Force urges HUD to adopt such an approach to economic and community development, one that works to achieve better schooling, improved health care and a decline in health disparities, and robust arts and culture as integral and necessary components to realize HUD’s goal of strengthening and sustaining vibrant communities, cities and, metro areas. HUD, with its focus on cities and on place, is *the* appropriate agency to take the lead within the Federal Government on these issues. Therefore, HUD can and should serve as a catalyst for intergovernmental cooperation, planning and programming. Government at all levels should be encouraged to develop inter- and intra-agency partnerships that break down silos that serve to prevent the interdepartmental cooperation and collaboration necessary to significantly improve the quality of life in our cities. The expertise, programs, and funding streams of multiple agencies should be integrated, coordinated, and combined as appropriate to obtain the results HUD seeks. HUD also has expertise in urban issues that should be tapped whenever government addresses and attempts to solve urban problems.

HUD should take a leading role in working with Federal agencies whose work impacts urban communities – e.g., Education, Health & Human Services, Commerce, Labor, Transportation, EPA, as well as state and local government – to promote a “New Collaborative Federalism.”

As recommended above, HUD could take the lead in forging a multi-agency Federal effort to advance the civic responsibility of Eds and Meds by hosting a National Summit or White House Conference. A number of programs, including the Harlem Children’s Zone, university-assisted community schools (e.g., Philadelphia, Tulsa, Dayton, Albuquerque), and the Manchester Bidwell Corporation in Pittsburgh, have developed approaches to stimulate intergovernmental collaboration at the local level that could be studied to identify promising practices with relevance for developing a national strategy.

The Anchors Task Force does not advocate that HUD alone expand its funding. Rather, HUD is needed to act as integrator of Federal resources across agencies. This is first and foremost a leadership issue. With White House support, the Task Force looks to HUD to institute these inter-departmental collaborations. HUD should take the lead in engaging Eds and Meds and other anchors in the necessary policy development and implementation. A working group could also identify the statutory barriers that must be addressed within each agency or by Congress to enable effective coordination of departmental funding.

A. Engage Eds and Meds, as well as other Anchor Institutions, in Community Economic Development

Universities, hospitals, cultural and arts centers, faith-based institutions, and other anchors are among our nation’s leading economic engines. The nation’s universities, for example, purchased over \$373 billion in goods and services in 2006, currently employ over two million full-time workers and over a million more part-time workers, enroll 18 million students, and retain endowments of roughly \$300 billion (\$411 billion before the 2008 crash). The nation’s hospitals employ over five million people, purchase over \$600 billion a year in goods and services, and have considerable investment assets.

Anchor institutions can support local economic development through several key practices, including:

- *Human Resources:* Anchor institutions can target training and recruitment programs to prioritize hiring local residents.
- *Real Estate Development:* Anchor institutions can help shape real estate development for community benefit.
- *Investment:* Anchors can invest in community development financial institutions to create capital for local community loans and business development.
- *Business Incubator:* Anchor institutions can establish programs that foster business development.
- *Local Purchasing:* Anchor institutions can redirect their purchasing to support local vendors.⁶⁴

Three examples that highlight these impacts are:

- *Human Resources Development:* In Philadelphia, the Skills Development Center (SDC) is an employer-driven program that provides individuals with opportunities, relationships and core skill sets necessary to compete in the work environment while addressing specific employment needs of the partner institutions in a cost-effective manner. It is a collaborative program involving employers, government agencies, training providers, community organizations, and public schools. The program addresses both a local and a national need for workforce

⁶⁴ The University of Pennsylvania illustrates the potential of this approach: in fiscal year 2008 alone, Penn purchased approximately \$89.6 million (approximately 11 percent of its total purchase order spending) from West Philadelphia suppliers; when Penn began its effort in 1986, its local spending was only \$1.3 million. Determining economic impact is an inexact science, but given that Penn has shifted more than \$85 million of its spending to West Philadelphia, a rough estimate would suggest that Penn’s effort has generated 160 additional local jobs and \$5 million more in local wages than if old spending patterns had stayed in place. This estimate for local purchasing effect is extrapolated from a study of Grand Rapids and surrounding Kent County in 2008, which found that if residents shifted 10 percent of their retail purchases to local stores (\$840 million), this would generate 1,614 new jobs, \$53.3 million in wages, and \$137.3 million in economic activity. Penn’s shift of \$85 million is one-tenth of this amount; see: Civic Economics, *Local Works: Examining the Impact of Local Business on the West Michigan Economy*, Austin, TX and Grand Rapids, MI: Civic Economics and Local First, September 2008. For further information on the Penn model, see research of Professor John Kromer, cited in: Radhika K. Fox and Sarah Treuhaft, with Regan Douglass *Shared Prosperity, Stronger Regions: An Agenda for Rebuilding America’s Older Core Cities*, Oakland, CA and Denver, CO: PolicyLink and Community Development Practitioners’ Network, 2006, pp. 70-72.

development that is employer-driven, regionally focused, and aligned across youth and adult-serving agencies. It is closely connected to health care institutions plus colleges and universities, collectively the largest employers in the Philadelphia-area. Over 700 incumbent workers in 2007-2008 participated in training through two members of the Skills Development Center: the University of Pennsylvania Health System and the Children's Hospital of Philadelphia. The training provided industry-recognized preparation, certification, and/or degrees in 17 high need employment areas. These areas include nursing, materials management, surgical technician, patient service representative, and medical coding. These programs are not only linked to jobs that will have substantial employment openings for the next several years, but they also provide employees with genuine career ladders.

- *Purchasing:* As detailed in footnote 8, by redirecting about ten percent of its purchasing to local sources, Penn has helped develop in West Philadelphia an additional 160 new jobs, \$3.3 million in wages, and \$13.7 million in economic activity. Penn's budget is about \$5 billion or roughly 1/200th of the total anchor institution budget nationally. If the rest of the anchor institutions in the nation could achieve half the shift in purchasing achieved by Penn, this might generate 16,000 new jobs, \$330 million in new wages, and \$1.37 billion in new economic activity.
- *Investment:* In Cincinnati, Ohio, the University of Cincinnati joined with four other large local nonprofit employers to form the Uptown Consortium, which is investing \$500 million in Cincinnati's poor Uptown neighborhoods, \$100 million of which is to be financed out of the university's nearly \$1 billion endowment. The initiative is expected to generate over 1,600 beds of student housing, over 1,000 units of affordable housing and roughly 450,000 square feet of commercial space. Nationwide, universities have over \$300 billion in endowment funds. If the average university made one-third the level of investment of the University of Cincinnati, they might be able to generate the production of over 100,000 units of affordable housing nationwide in addition to contributing to overall economic development through mixed-use developments.

1. Recommendations

The recommendations below aim to leverage HUD dollars by deepening and extending current anchor institution-based initiatives for community economic development:

Recommendation 9.1: Launch an Anchors Build Community program that provides seed funding to jumpstart efforts at individual institutions in local purchasing, hiring, business incubation, and community investment. HUD could catalyze beginning institutions to further meet community development goals by underwriting part of the up-front cost to develop their systems.

Recommendation 9.2: Convene a multi-stakeholder group, the Integrated Community Anchor Network (I-CAN) that can support cross-anchor institution collaborative efforts. A model for this effort might be the *Living Cities* consortium, which began as a 10-year commitment in 1991 by foundations and an insurance company to expand the work of community development corporations in 23 cities, in which both HUD and HHS now participate as significant funding partners. Partners HUD might work with to launch I-CAN include the Departments of Health & Human Services, Labor, Education, and Commerce, the proposed White House Office of Urban Policy, the proposed Office of Social Innovation in the Corporation for National and Community Service, as well as foundations, and community college, university, academic medical center, and hospital national associations.⁶⁵

Recommendation 9.3: Provide a pool of capital—grants and loans—that can supply matching funding for innovative state or local grant proposals through which state, regional, or local governments might encourage anchor institutions to leverage their assets. For example, a state could provide a credit enhancement that leverages hospitals and university endowment funds.

⁶⁵ A request-for-proposals (RFP) that selected an initial slate of I-CAN cities might include the following criteria: a) clear objectives in terms of local investment, local purchasing, hiring in low-income communities, business incubation, green job development, and wealth creation; b) clear delineation of how economic development objectives will connect with core institutional programs – e.g., education for universities and health care for hospitals; c) indication of institutional support at the CEO/Presidential level and of a commitment of internal funds and in-kind support; d) evidence of state and local government support; e) inclusion of community development corporation and other local community groups in the development of goals and objectives; and f) clear metrics to track the impact anchor institution investments in community building have over time.

Recommendation 9.4: Develop a system of Community Economic Development Centers to provide research, planning, technical assistance and project-based support to distressed urban communities. Such Centers could help leverage university intellectual resources, in partnership with local non-profit organizations, to undertake community development and affordable housing projects.

Recommendation 9.5: Support education, training, and data analysis as a core feature of the HUD Office of University Partnerships' work. Minimally, this would include the following:

- a. Develop a series of field-specific national and regional trainings to disseminate best practices, with training conducted by experts in the field.
- b. Issue grants to develop effective written “tools” for different aspects of anchor-led community economic development and make those tools available as part of an “anchor institution toolkit” on the HUD Office of University Partnerships website.⁶⁶
- c. Identify key target outcomes for anchor community economic development work and track results annually. Conduct rigorous external evaluations of program outcomes.
- d. On a biennial basis, hold a meeting of CEOs and/or Presidents of grantees to share results and ensure the high-level commitment needed to make the Network a success.

B. Engage Eds and Meds and Other Anchor Institutions in Workforce Development and Community Building (Primary Partner: Department of Labor [DOL])

Universities, community colleges, and other anchor institutions today offer a range of workforce development programs. We recommend that HUD partner with the Department of Labor to work with academic anchor institutions and encourage them to expand their offerings in two areas: (1) to support green careers, with a focus on greening HUD-supported affordable housing; and (2) to train a new generation of community developers to replace community leaders from the “baby boom” generation who are likely to retire in the next decade.

It has been estimated that for energy efficiency reasons there is a need to retrofit 3.5 million HUD-supported existing units of affordable rental housing across the country. If the opportunity is seized, this effort could be used to expand job opportunities for disadvantaged groups. The growing “green economy” is already big business. As of 2006, there were 196,000 jobs in the United States in renewable energy with a gross value of \$39.2 billion. If 20 percent of the nation’s electricity came from renewable energy by 2020, this would employ between 163,000 and 188,000 people, while traditional fossil fuel strategies would employ fewer than 90,000. From the perspective of community development, a critical issue is linking these jobs to building community jobs and wealth, which provides a particular opportunity for the engagement of community colleges.

Moreover, an acute labor shortage faces community-based developers and organizations, a result of the fact that the “sixties generation” that founded many community development corporations and other community groups is nearing retirement. As a result, there is a pressing need for developing an education system that can generate the community infrastructure that HUD relies on for many of its programs.

1. Recommendations

The recommendations below aim to leverage HUD dollars as far as possible by deepening and extending current anchor institution-based initiatives:

Recommendation 9.6: Within the HUD Office of University Partnerships, create a workforce development program with an explicit focus on meeting HUD community economic development objectives.

- *Launch a Youth Green America program that employs youth aged 17 to 24 in energy retrofit programs benefiting existing HUD-supported affordable housing stock.* The opportunity exists for HUD to play a leadership role in green

⁶⁶ For a sample of the type of documents that need to be generated, see Eleanor Sharpe, *Anchor Institutions Toolkit: A guide for neighborhood revitalization*, Philadelphia, PA: The Netter Center for Community Partnerships at the University of Pennsylvania, March 2008.

workforce development by establishing this national grants program. Eligibility would be restricted to out-of-school youth ages 17 to 24 residing in high poverty neighborhoods. Sponsoring universities, hospitals and other large anchor employers would draw on their sophisticated and extensive environmental, greening, and housing initiatives.

- *Launch a Youth Rebuilding Communities program to work in coordination with local community development corporations and other community based-organizations to train a new generation of leadership as well as provide other workforce development opportunities.* Los Angeles Trade Technical College's two-year Associate of Arts degree in Community Development, with the Community Development Technologies Center, offers a model for how HUD, allied with anchor institutions, can approach this issue. The LA Tech program enrolls about 15 students a year, with most hailing from low-income neighborhoods. The curriculum includes courses on community planning, real estate development, project financing, nonprofit management, and community organizing, with a faculty largely composed of practitioners.

C. Link Communities to Health Care Institutions (Primary Partner: Health and Human Services [HHS])

Health disparities – most often manifested in low-income, minority communities – is another issue that Eds and Meds can and should address. The importance of community health for urban revitalization has rapidly gained recognition over the past decade. Research recognizes that individuals are embedded in social, political and economic systems that shape behavior and access to needed recourses. This body of research also forcefully argues for collaboration among community development and health care specialists to reduce the incidence rates of asthma and obesity, among other illnesses, which are particularly high in minority communities.

An important focus of academic medical centers should be – and increasingly is – public health. Academic medical centers tend to be the most powerful of anchor institutions, as well as the most resource-rich, prestigious, and influential component of universities. Moreover, the largest body of academic resources across the entire campus (arts and sciences, law, business, engineering, etc.) at many universities with major academic health centers tends to be focused on health-related issues. The important role of academic health centers in educating health professionals and students in community-based research and service-learning, as well as in improving urban public health, has been recognized by organizations such as Community-Campus Partnerships for Health and the International Society for Urban Health. The Task Force encourages HUD to play an active role as a partner with HHS in developing place-based programs involving Eds and Meds.

1. Recommendations

The recommendations below aim to leverage HUD dollars to achieve both public health and community development objectives:

Recommendation 9.7: HUD's Office of University Partnerships should create a Community Health Program to link anchor institutions to community groups to achieve healthier communities. In particular, this Program should include the following:

- Health Partnership Capacity Grants that aim to build anchor capacity to engage in community health partnerships. Grants awarded will focus on developing the supporting infrastructure for effective community partnership work through the funding of health partnership centers. These Centers' purposes include helping recruit health professionals and administrators to participate in community partnership work, creating scholarships, initiating start-up public health intervention programs, developing partnership relationships with community groups, and building overall anchor technical assistance capacity to support those community groups.
- Launch a Community Health Anchor Partnerships (CHAP) program that provides seed funding to facilitate project-based partnerships for community economic development and the improvement of community health. Projects funded through CHAP could include support for new and existing Ed-and-Med-assisted school-based health centers, programs that train community development corporations to inspect the affordable housing

units they manage and make building modifications to improve resident health, “train the trainer” programs where health professionals train community groups to do first-level health screenings, and school-to-career employment programs linked to the health professions.

- Support education, training, and data analysis as a core feature of this work. Minimally, this would include the following:
 - Develop a series of field-specific national and regional trainings to disseminate best practices, with training conducted by experts in the field.
 - Identify key target outcomes for anchor institution community health partnership work and track results annually. Conduct rigorous external evaluations of program outcomes.
 - Hold a biennial meeting of CEOs and/or Presidents of grantee institutions to share results and ensure the high-level commitment needed to make the Network a success.
 - Maintain links with relevant efforts in Health & Human Services and the National Institutes of Health.

D. Support K-20 education and professional education to promote (1) leadership in community development field; and (2) public schools as core institutions for community revitalization (Primary Partners: Department of Education [DOE] and Corporation for National and Community Service [CNCS])

Higher education has the unique capacity to address a range of education-related needs that help support the field of community development as well as to address the broader issues of the interconnection of community development and successful schooling. The first set of recommendations offers options for a pipeline of community development professionals from high school, to college, to post-graduate education and beyond. The Task Force also includes recommendations that help address one of the most pressing issues in urban America, its public schools.

Successful community development and successful schooling are interconnected and interdependent. The quality of public schools in large cities is, if not *the* most important problem, certainly among the most important problems in urban America. Drop-out rates in many of America’s largest cities exceed 50% and a recent study of college completion rates in Chicago (among America’s stronger big city school systems) found that that only 3% of African-American and Hispanic males in Chicago public schools in ninth grade had completed four-year college degrees by the age of 25. Poor school performance is first and foremost a tragedy for those students who enter the workforce with inadequate skills. It is also, however, a major barrier to urban revitalization. High-skill workers, drawn to core cities by urban amenities and job opportunities, often leave the city when their children become of school age, depriving cities of energy, ideas and tax base. The same problems of urban education that have long plagued major cities have increasingly been an issue for inner-ring suburbs as well. The renaissance of urban America requires high-quality urban schools.

Institutions of higher learning are intrinsically linked to issues of K-12 education. Universities train the teachers, principals and social workers that are the human capital base of public schools. Universities and grades Pre-K through 12 are all part of the same schooling system. At an increasing number of urban universities, public education has become an arena in which the university combines service to local communities, training of the next generation of professionals and the creation of new knowledge through work to improve local schools. Indeed, approximately 35 percent of institutions of higher education that received COPC funding developed partnerships with schools. This was by far the primary focus of COPC-supported partnerships. For urban universities, the importance of public education is also an issue of institutional success. Universities, like other anchor institutions, need strong neighborhoods in order to succeed. Without strong public school systems, strong local neighborhoods are perhaps impossible to achieve.

Moreover, school partnerships have an obvious, albeit long-term, economic impact. For instance, the Preuss School at UC San Diego, which recruits about 100 students per year (760 students in grades 6-12 from low-income census tracts), had 96 percent of its graduates in 2007 accepted into a four-year college or university. By contrast, the average high school graduation rate in San Diego is 61.6 percent. In other words, the school minimally graduates 35 more students per year than the competing public schools: an economic value for these students in lifetime earnings of an estimated \$260,000 per student or \$9.1 million per school year. According to a 2005 study, high school dropouts cost

the nation \$192 billion, or 1.6 percent of the gross domestic product; a number that might be cut in half with strong Federal support for university-school-community partnerships. This result would have an economic impact of nearly \$100 billion.⁶⁷

1. Short-term Recommendations

Recommendation 9.8: Fund the programs in the Office of University Partnerships that support training of early career professionals: Community Development Work-Study, Early Researcher Awards and Doctoral Dissertation Research Grants. Furthermore, tie Federal support for work-study to community initiatives through financial incentives. Work-study is among the largest Federal programs of educational assistance. Many work-study positions are on campus, replacing low-skill labor. It would be far better for communities and students if work-study students were required to work in public schools or other community organizations. After-school programs are a particularly promising area for student work.

Recommendation 9.9: Create a pipeline of qualified community development professionals, from high school through 20+. Universities can make a significant contribution to the field of community organizing and community development by tapping their resources to train in-service professionals. Individuals in community agencies, housing counseling, and community development corporations require ongoing professional development opportunities if they are to work to maximum effect. A pipeline program could effectively engage individuals from school-age through those in professional careers. HUD should encourage development of such programs with initial seed funding, with the requirement that a long-term sustainability plan be developed for the program with university and other local resources.

Recommendation 9.10: Champion the American Opportunity Tax Credit to support college education. HUD has a significant opportunity to support President Obama's goal of increasing access to higher education while furthering HUD's mission of revitalizing America's cities. President Obama has proposed an American Opportunity Tax Credit to assist students with financial aid for college. As part of that initiative, students would receive the credit for service in urban communities and schools. Ideally, this would be linked to their course of study.

Recommendation 9.11: Establish K-20 urban planning curricula. Universities should be encouraged by HUD, working with the DOE, including its 21st Century Community Learning Center program and the Hoyer-supported Full Service Community Schools initiative, to develop urban planning curriculum in high schools. Curricula would be developed and implemented with the assistance of university faculty and students working in service-learning courses. Commitment to urban issues and development of the knowledge and skills to address these real-world problems needs to be cultivated K-20, particularly with high school students and undergraduates. Among the most often stated reasons for dropping out of high school – the most important predictor of lifetime earning ability and incarceration – is lack of interest and relevance of the curriculum. Students feel unchallenged and the curriculum is divorced from their life experiences. The issues of the neighborhood can effectively function as the text and test for learning. Regional HUD staff, as well as local city planners and community partners, could make a significant contribution to this learning experience.

Recommendation 9.12: In partnership with the Corporation for National and Community Service, HUD could co-sponsor an Urban Revitalization Corps that would engage young people in local communities. Students could be part-time corps members serving while in school with an education benefit after service from CNCS. The most committed students could apply for a HUD-sponsored equivalent to Teach for America, in which they would devote a year or two post-graduation toward working in the communities in which they had performed their undergraduate service. Regional HUD offices and local government would work closely with higher education to most fully utilize the talents of these students.

⁶⁷ Cecilia Elena Rouse, *The Labor Market Consequences of an Inadequate Education*, Prepared for the Equity Symposium on "The Social Costs of Inadequate Education" at Teachers' College, Columbia University: September 2005, page 25. On San Diego graduation rate, see Ken Thomas, "Report: Low graduation rates in many city school districts," *Associated Press*, March 31, 2008, www.signonsandiego.com/news/education/20080331-2101-highschoolgradrates.html. On Preuss, see: The Preuss School UCSD, *Fact Sheet*, La Jolla, CA: Preuss, 2007, <http://preuss.ucsd.edu/about/fact.php>, accessed Jan. 14, 2009

2. Long-term Recommendations

Long-term strategies are designed to help address operational and structural issues that can help improve public education K-12 through partnerships with Eds and Meds and other anchor institutions.

Recommendation 9.13: Expand university-assisted community school initiatives. One of the most promising areas of involvement in local education and community improvement is the sponsorship of community school initiatives that combine after-school programs, tutoring and mentoring for students with support for families. Community schools bring in a range of support services for families to address housing, job training, health, and other needs. Many community schools have seen decreased mobility of families as these services allow them to remain in their current residence and as students develop a deep connection to the school and the services it offers to them. Significant work is being done in Portland, Philadelphia, Tulsa, Dayton, Baltimore, and Indianapolis. This work is being studied and promoted by the national Coalition for Community Schools, which has over 160 organizational partners in K-12 education, higher education, youth development, community planning and development, family support, health and human services, government and philanthropy as well as national, state and local community school networks. A demonstration community schools project sponsored by the Federal Government in 2008 [see Hoyer Full Service Community Schools initiative above] received over 450 applications, only ten of which could be funded.

University-assisted community schools also exist in cities across the United States. These schools help educate, engage, empower, and serve *all* members of the community in which the school is located. At the same time, working with community members to create and sustain university-assisted community schools provides a powerful means for universities to advance teaching, research, learning and service, as well as the civic development of their students. This approach works toward tapping, integrating, mobilizing, and galvanizing the vast resources of communities – especially colleges and universities – to improve the community, the school, and the education of students. The work is integrated into both the public school's and university's curricula, creating a K-20 real-world problem solving approach and fostering sustainable partnerships. Students not only learn by doing, but also learn by and for service. Most importantly, university-assisted community schools develop neighborly communities capable of helping students and residents to solve strategic real-world problems that confront them.

HUD could work in cooperation with the new Secretary of Education, who developed more than 150 community schools (as well as university-sponsored schools) in Chicago as part of his education reform strategy, to create and expand university-assisted community schools. HUD would help to support those aspects of community schools that help develop integrated community-focused curriculum, and development of adult-oriented programs that support job training, skills building, as well as housing and credit counseling, housing repairs and the like.

Recommendation 9.14: Create a grant program to support the establishment of school-centered community development centers in distressed urban communities. OUP should partner with the DOE in this initiative. The school-centered community development approach is based on the premise that underperforming schools and distressed urban neighborhoods are intertwined problems, which cannot be solved independently of one another. Put another way, the problem of underperforming schools cannot be solved without the transformation of distressed urban neighborhoods, and the problem of distressed neighborhoods cannot be solved without the transformation of schools. Consequently, a community development strategy that integrates school reform and neighborhood development will be more successful than a strategy that focuses only on the neighborhood regeneration or only on school reform. Few will debate that the daily struggle of parents to survive, the stress of trying to maneuver safely to and from school, grappling with negative peer pressure, along with the problems of obesity and poor health, will contribute to academic underachievement.

School-centered community development accounts for the dynamic, interactive relationship between families, schools and neighborhoods by fusing school reform and neighborhood development into a *single* integrated approach to community regeneration. While school centered community development is still in its early stages, projects based on this approach in Buffalo, Syracuse, Philadelphia, Atlanta, Baltimore, Chicago, and St. Paul suggest that it has great promise and can be a powerful tool in the quest to build sustainable, healthy neighborhoods. Local Initiatives Support Corporation (LISC) and Enterprise Community Partners are among the proponents of school-centered development and Enterprise has supported this work in Baltimore and Atlanta. School-centered community development is not driven by a particular school reform strategy; rather it complements existing reform strategies by creating pathways

that connect the school to the community via curriculum and academically based service learning and neighborhood development activities taking place in the community.

Concurrently, school-centered community development also builds on what we already know about neighborhood development. The objective is to find creative and innovative ways to connect schools to the neighborhood development process, so that an interactive, two-way street is developed between school reform and neighborhood development.

E. Increase role of Eds and Meds and other anchors as Cultural Catalysts (Primary Partners: National Endowment for the Arts [NEA] and National Endowment for the Humanities [NEH])

Many universities play a central role as cultural catalysts in their communities. They provide performing arts facilities and working space for artists, employ faculties devoted to arts and culture, commission new work, present work, and train students in the field. They are also potential centers of diversity as expressed through the arts.

Just as creativity thrives on those campuses where there is abundant cross-cultural exchange and a great deal of “border” activity between disciplines, where collaborative work is commonplace, risk-taking is rewarded, failure is expected, and the creative arts are pervasive and integrated into campus life, the same is true in the broader community.

Colleges and universities can foster these types of attitudes and behaviors in the broader community. Universities can also collaborate directly with arts institutions to influence the community in ways neither could do on their own, especially in older industrial cities in need of creative initiatives.

A model of this is Syracuse University’s instigation of a “connective corridor” to link the university and the city’s arts and cultural institutions. A national competition resulted in the selection of Field Operations and CLEAR to produce the “Syracuse L.” It is a mixed-use incentive zone that stitches together the city’s scattered institutional and commercial fabric through the strategic intensification of a small area of the city and the addition of transit. The “L” is intended not only to enhance what is there but also to spur new development, including shops, hotels, cinemas and media centers.

1. Recommendations

Recommendation 9.15: HUD should support these cultural collaborations through partnerships with NEA and NEH (and in the case of Syracuse, Department of Transportation [DOT]), as well as with local and state governmental cultural organizations. Cultural development, of course, has increasingly become a major economic development strategy for cities and metropolitan areas. National higher education consortiums, such as Imagining America: Artists and Scholars in Public Life, a consortium of nearly 90 higher educational institutions, could be a key partner in developing these approaches. Moreover, a new OUP program could encourage the involvement of faculty in the humanities and the arts to help develop and advance cultural development of the sort described above.

F. Utilize Eds and Meds as Catalysts, Facilitators and Conveners for Regional Development

As argued in the Regionalism Working Paper, many of the most pressing economic, environmental and social issues facing the country are regional in scale and nature. They cannot be understood or solved within the confines of a neighborhood or a city, and they need the focused and continuous attention of universities and other anchor institutions as regional civic leaders. Whatever the issue or collection of interconnected issues: transportation, air quality, economic competitiveness, education, housing, or homelessness, to name a few – each metropolitan area needs to craft and sustain distinct partnerships for regional action. In the coming years, HUD should act on the new

realities of the U.S. becoming a ‘metro nation,’ and universities should be encouraged and supported to play a significant part in metropolitan-scale civic engagement.

Effective metropolitan regions have respected organizations that bring together the many legitimate constituencies of urban life to reflect on the status of regional development and make plans for improvement. These organizations assemble data, bring in national experts, invite respectful discussion and create forums for problem solving. While the necessary participants may vary depending on the issue, the goal is inclusion of diverse interests that must be represented to achieve regional success. Active discussion and dialogue can often find common ground where it might appear to be absent.

Institutions of higher education in a metropolitan area are sometimes competitive with each other, sometimes complementary, and indeed often both, but they have increasingly recognized the need to work together to prepare the workforce, provide intellectual support to the leading and emerging sectors of the regional economy, and provide information and guidance for regional public policy-making. It is in their enlightened self-interest to build an economically healthier, more socially just region, and there are many different ways by which to do so.

There are several types of regional leadership to which institutions of higher education can contribute, and which HUD should foster and support. Groups of universities and colleges can establish long-term partnerships through which their applied research, community service, and economic impact can all be coordinated for greater impact and efficiency. Consortia to train teachers, promote best practices for alleviating homelessness, and develop new technologies for regional economic clusters are all cases in which the combined efforts of multiple campuses outweigh the efforts of schools that go it alone.

Metropolitan planning and transportation organizations need the contributions of universities’ research as well as the presence of large institutions as conveners for regional initiatives. With regard to housing, universities are the repository of most of the research and technical expertise on finance, planning and construction, but they are also large generators of housing demand, and they cannot recruit or function effectively if serious regional supply and affordability problems exist.

1. Recommendations

Recommendation 9.16: Create an applied, action research grant program specifically for universities to address regional issues in partnership with one or more metropolitan planning organizations or broadly based civic groups. One collection of awards would be for issues traditionally associated with regional planning, including housing, homelessness, transportation, land use, and economic development. A second collection would be for new issues that have not typically been addressed on a regional scale but which would benefit from that approach.

Recommendation 9.17: Create a grant program for the establishment or expansion of collaborations among institutions of higher education and other anchor institutions in a metropolitan region for purposes of civic engagement and community economic development. Regional collaboration could include applied, action research; workforce development and training; community service; combined business activities (including construction, purchasing and procurement); convening of stakeholders for planning and policy-making; or other broad goals which can be enhanced by the activities of higher educational institutions. Applicants would need to demonstrate that their approach to civic engagement and community economic development extend beyond formal government and corporate leadership structures to grass-roots organizations in socioeconomically and racially diverse communities.

Recommendation 9.18: Review all HUD programs that have a regional focus to determine whether there could and should be a means by which the involvement of universities could be encouraged.

CONCLUSION

We conclude by rephrasing and expanding upon a central point made in the report's introduction:

President Obama has called for a “New Era of Service.” This challenge to serve applies not only to students, but also to institutions, including community colleges, four-year colleges, and universities. Eds and Meds, and anchor institutions in general, have a powerful opportunity to increase their contribution to the public good. Now is an opportune moment to create a new compact between government, anchor institutions and their communities.

President Obama has outlined an inspiring vision of how communities, cities, and metropolitan regions would function in a truly democratic, truly progressive American society. This report and its recommendations, the Task Force believes, would help exemplify and implement this vision.

PART 3: BUILDING HUD'S CAPACITY and DEVELOPING NEW INITIATIVES



RETOOLING HUD

for a CATALYTIC FEDERAL GOVERNMENT:
a REPORT to SECRETARY SHAUN DONOVAN

Penn Institute for Urban Research
University of Pennsylvania

CHAPTER 9

FACILITATING GREEN HOUSING

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

INTRODUCTION

A. The Strategic Opportunity

The green building retrofit market is central to the development of our nation's green economy. The gross economic impact of retrofitting half our nation's housing stock would be \$640 billion in expenditures. This could create up to 7 million jobs and generate \$9.6 billion in new tax revenues.⁶⁸ There would be a 25% reduction in on-going energy costs with a return on investment of 12%.

The U.S. Department of Housing and Urban Development (HUD) has direct influence over 10% of the nation's housing stock and indirectly influences much more of the stock through its interactions with state and local government and financial institutions ranging from banks to Fannie Mae and Freddie Mac.⁶⁹ This level of market presence allows it to influence energy efficiency not only in its own housing stock but in the overall market.

B. Assumptions about the Green Housing Market

The Task Force recommendations are based on the following assumptions about the overall green building market:

- A green building strategy has to cover multiple dimensions of building “greening.” Primary among these are location efficiency; energy and water efficiency; storm-water management through green infrastructure⁷⁰; health and the indoor environment (including lead-based paint standards).
- Only 1% of new housing is added to the housing stock each year. So the bulk of green building opportunities are in existing buildings.
- Investing in green building improvements can simultaneously achieve multiple benefits:
 - Creation of new jobs
 - Improvement of real estate values
 - Reduction in operating costs
 - Improvement in community health
 - Reduction in greenhouse gas (GHG) emissions and other environmental hazards
 - Preservation of the existing affordable housing stock
 - Alignment of Federal housing, energy, climate, workforce and economic development, urban, and transportation policies

⁶⁸ Based on the following assumptions: 1) 128 million existing residential housing units; 2) average cost of a retrofit = \$10K; 3) \$100K of retrofit work generates 1.11 jobs and \$30K in tax revenue, per NAHB methodology. Note that here and throughout the document, the term “jobs” refers to “one year of wages equivalent.” Assuming the total activity lasts more than one year, the job impact is proportionately diminished.

⁶⁹ HUD has direct involvement in 1.2 million units of public housing through its funding relationship with 3,300 Public Housing Authorities; 2.0 million rental units through Section 8 vouchers; and 1.6 million units in multi-family housing through programs in its Office of Multi-Family Housing. This adds up to a total of 4.8 million units, or 3.8% of the total of 128 million housing units nation-wide. In addition, it enforces a construction code that covers 6.3 million units of manufactured/mobile housing (4.9% of the total U.S. stock). Finally, HUD touches many more housing units through its Community Development Block Grants; HOME investment partnerships; urban revitalization programs; and private lending insurance.

⁷⁰ Green infrastructure practices include rain gardens, porous pavements, green roofs, infiltration planters, trees and tree boxes, and rainwater harvesting for non-potable uses such as toilet flushing and landscape irrigation. (http://cfpub.epa.gov/npdes/home.cfm?program_id=298)

- The Obama Administration’s building energy efficiency goals cannot be met through government programs alone. This will require the development of a robust and self-reinforcing market for investment in building energy efficiency. Government programs such as those in HUD can play a role in creating this market by demonstrating leadership; creating incentives through policy, credit enhancement, regulation and investing in R&D; and supporting private market innovators.
- Because housing markets, labor markets and climates are regional in nature, effective strategies for large-scale residential retrofits need to be customized at the regional level.

C. Link to Key Obama Administration Goals

The strategies and recommendations outlined in this report can help achieve key Obama administration goals, including:

- Improve existing building energy efficiency by 25% by 2030.
- Improve new building efficiency by 50%.
- Weatherize one million low-income homes each year for the next ten years, achieving 20% to 40% energy savings in each home.
- Provide incentives for property owners to eliminate lead hazards.

D. Positive Impacts

The recommended investments would have the following impacts:

- A total of 3.5 million housing units would be retrofitted (general building system upgrades with energy efficiency and environmental health improvements).
- A direct HUD investment of \$25.7 billion would leverage an additional \$29.7 billion, for a total investment in the housing retrofit market of \$55.4 billion.
- A total of 590,700 direct jobs would be created.
- A total of 1.5 million indirect jobs would be created.
- HUD would save an estimated \$206 million per year in direct energy costs.

E. Connection to HUD Mission and Goals

The current HUD mission is to: *“Increase homeownership, support community development, and increase access to affordable housing free from discrimination.”*⁷¹ The recommendations in this report directly address two of the three strategic imperatives in this mission:

- Energy efficiency and retrofit improvements in housing reduce energy and maintenance costs, therefore increasing affordability.
- Development of a national building energy efficiency retrofit market would increase household disposable incomes through reduced energy costs, create jobs, and spawn new businesses, therefore contributing significantly to community development.

⁷¹ HUD Strategic Plan, FY 2006-2011. Another task force recommends modifying this mission statement.

EXECUTIVE SUMMARY OF RECOMMENDATIONS

A. Vision

HUD takes the lead in revitalizing the U.S. construction, finance, and real estate sectors through a robust green building retrofit market that contributes hundreds of billions of dollars to the U.S. economy over the next two decades and creates several million new jobs.

B. Strategy Summary

We recommend four broad strategies.

1. Aggressively green the HUD housing portfolio.
2. Make HUD a leader in the development of the national green building retrofitting market.
3. Locate housing to create transit-oriented, walkable and accessible communities.
4. Under White House leadership, organize a cross-departmental national strategy for green building retrofits as an economic sector development strategy.

C. Strategy Detail

The table below summarizes the Task Force recommendations in each of these four areas. It also categorizes the recommendations as follows:

- **Short/long term:** Indicates whether the impact and implementation is generally short term (within two years) or long term.
- **New funding:** Indicates that the recommendation will require new funding in the HUD budget.
- **Existing authority:** Indicates that this action can be undertaken with existing regulatory authority.
- **Demo project:** Indicates recommendations that involve a demonstration project.

HUD Greening Task Force Recommendations	Characteristics			
	Short/Long Term	New Funding	Existing Authority	Demo Project
Strategy 1 – Aggressively Green the HUD Housing Portfolio				
1.1 Create a Public Housing Retrofit Fund to accelerate the retrofitting of the 1.2 million existing Public Housing Authority units.	Short	X		
1.2 Retrofit 100,000 Project-Based Section 8 units.	Short	X		
1.3 Retrofit 20,000 Section 202 and Section 811 units.	Short	X		
1.4 Green 10,000 units of HOPE VI housing.	Short	X		
1.5 Retrofit 300,000 units of housing through the HOME block grant.	Short	X		
1.6 Green 15,000 units abated annually through healthy homes and lead hazard control grants.	Short	X		
1.7 Create incentives for PHA’s to invest in energy efficiency retrofits.	Long		X	
1.8 Create incentives for CDBG funds to incorporate investments in energy efficiency.	Long	X	X	
1.9 Upgrade manufacturing housing codes to incorporate updated energy efficiency standards.	Short		X	
1.10 Require HUD-financed new construction to meet progressive green building standards.	Short		X	
1.11 Increase Total Development Costs for Green Development.	Short		X	
1.12 Invest in building energy information systems.	Short	X		X
1.13 Change the way HUD pays for energy costs.	Short		X	
1.14 Demonstrate leadership in energy demand management.	Long	X		X

HUD Greening Task Force Recommendations	Characteristics			
	Short/Long Term	New Funding	Existing Authority	Demo Project
Strategy 2 – Make HUD a Leader in the Development of the National Building Retrofit Market				
2.1 Create a \$5 billion national Building Energy Efficiency Finance (BEEF) Fund to develop the national retrofit market.	Short	X		X
2.2 Create a national technical assistance and capacity building network to support building retrofit strategies.	Short	X		
2.3 Create a HUD Office of Sustainable Development.	Short	X		
2.4 Invest in the R&D strategies of the Partnership for Advanced Technology in Housing (PATH) initiative.	Short	X		
2.5 Invest in the development of a national carbon credit aggregation infrastructure for building efficiency.	Long	X		
2.6 Explore ways to use Fannie Mae and Freddie Mac to advance greening of the national housing stock.	Long		X	
Strategy 3 – Locate Housing to Create Transit-Oriented, Walk-able and Accessible Communities				
3.1 Require HUD-financed building to incorporate incentives for location-efficiency.	Long		X	
3.2 Raise Total Development Cost limits in urban areas to encourage the development of infill housing and transit-oriented development.	Long		X	
3.3 Explore the redefinition of “affordable” housing to incorporate costs of transportation & energy, as well as housing costs.	Long		X	
Strategy 4 – Under White House Leadership, Organize a Cross-Departmental National Strategy For Green Building Retrofits as an Economic Sector Development Strategy				
4.1 Fully fund the Energy Efficiency and Conservation Block Grant program in the Department of Energy.	Short	X (Energy)	X	
4.2 Create an accelerated program to help public and affordable housing residents access green job training.	Short	X (DOL)		X
4.3 Increase funding for residential energy efficiency tax credits.	Short	X (Treasury)		
4.4 Create a national supply chain development strategy to serve the building retrofit market.	Long			

D. Summary of Recommended Investment Amounts

The recommendations that have direct budget implications are summarized below.

Summary of Budget Implications of Recommendations					
Recommendation	Direct HUD Investment	Leveraged Capital	Total Capital	Cost Per Unit	Total Units
Strategy 1 -- Greening of HUD Portfolio					
Public Housing Retrofit Fund	\$13,320,000,000	\$1,080,000,000	\$14,400,000,000	\$30,000	480,000
Project Based Section 8	\$4,000,000,000	\$0	\$4,000,000,000	\$40,000	100,000
Section 202 and 811	\$800,000,000	\$0	\$800,000,000	\$40,000	20,000
HOPE VI Green Projects	\$310,000,000	\$0	\$310,000,000	\$10,000	31,000
HOME Grants	\$1,800,000,000	\$7,200,000,000	\$9,000,000,000	\$30,000	300,000
Greening Lead Abatement Units	\$150,000,000	\$0	\$150,000,000	\$10,000	15,000
Building Information Systems	\$10,000,000	\$0	\$10,000,000		
Energy Demand Mgt	\$50,000,000	\$0	\$50,000,000		
Strategy 2 -- National Market Development					
Building Energy Efficiency Finance Fund	\$5,000,000,000	\$20,250,000,000	\$25,250,000,000	\$10,000	2,525,000
National Capacity Building Network	\$10,000,000				
R&D to Support Market Development	\$50,000,000	\$0	\$50,000,000		
Housing Carbon Credit Infrastructure	\$50,000,000	\$0	\$50,000,000		
Total	\$25,550,000,000	\$28,530,000,000	\$54,070,000,000		3,471,000

E. Summary of Energy and Job Impacts

The energy savings to HUD and the direct and indirect job impacts of these investments are summarized below.

Investment Area	Direct HUD Investment	Leveraged Capital	Total Capital	Potential HUD Energy Savings	Direct Job Creation	Indirect Job Creation
Public Housing Retrofit Fund	\$13,320,000,000	\$1,080,000,000	\$14,400,000,000	\$168,000,000	158,400	403,200
Project Based Section 8	\$4,000,000,000	\$0	\$4,000,000,000	\$30,000,000	44,000	112,000
Section 202 and 811	\$800,000,000	\$0	\$800,000,000	\$6,000,000	8,800	22,400
HOPE VI Green Projects	\$100,000,000	\$0	\$100,000,000	\$2,000,000	1,100	2,800
HOME Grants	\$1,800,000,000	\$7,200,000,000	\$9,000,000,000		99,000	252,000
Green Lead Hazard Control Units	\$150,000,000	\$0	\$150,000,000		1,650	4,200
Building Energy Efficiency Finance Fund	\$5,000,000,000	\$20,250,000,000	\$25,250,000,000		277,750	707,000
Total	\$25,170,000,000	\$28,530,000,000	\$53,700,000,000	\$206,000,000	590,700	1,503,600

Assumptions underlying these projections include:

- For every \$100,000 of investment, 1.1 direct jobs are created.⁷²
- For every \$100,000 of investment, 2.8 indirect jobs are created.⁷³
- Each green retrofit unit results in an average of 25% of energy savings.⁷⁴

STRATEGY 1 – Aggressively Green the HUD Housing Portfolio

A number of strategies are recommended to aggressively retrofit the existing HUD housing portfolio. These recommendations fall into two basic categories:

- Direct investments in retrofitting of the HUD housing portfolio. These investments combine general retrofits and green retrofits in most cases.
- Regulations, standards, and R&D to incentivize additional greening in the HUD housing portfolio.

The direct investment recommendations are proposed to extend for a three-year time frame (so total costs would be one-third in each year.) The total amount of the proposed direct HUD investments is \$20.47 billion. This investment would leverage an additional \$9.48 billion in private capital, for a total investment of almost \$30 billion.

A. Direct Investments in the HUD Housing Portfolio

Recommendation 1.1: Public Housing Retrofit Fund

Short Term, New Funding

The creation of a Public Housing Retrofit (PHR) Fund is recommended to accelerate the retrofitting of the 1.2 million of existing Public Housing Authority (PHA) units.⁷⁵ The PHR fund would invest in both general retrofits of units and “green” retrofits of units. The assumptions behind this fund include:

- 40% of the total 1.2 million units = 480,000 units to be retrofitted.
- The average cost to retrofit a public housing unit is \$30,000. Approximately \$20,000 of this cost is for general retrofitting, and \$10,000 is for “green” retrofitting that specifically addresses energy- and water-efficiency and internal environmental quality.
- 100% of the costs for general retrofits would be fully subsidized.
- 75% of the costs for “green” retrofits would be fully subsidized.
- The remaining 25% of the green retrofits would be financed through energy performance contracts with Energy Service Companies (ESCOs)⁷⁶ or another leveraged approach. A 10% guarantee fund from HUD would be required to reduce the risk of these deals enough to attract private investors into this market.

⁷² National Association of Home Builders

⁷³ National Association of Home Builders

⁷⁴ The amounts shown in the table above assume savings of 25% on HUD energy expenditures for the units retrofitted with these dollars. It assumes an average annual energy bill per unit of \$1,200-\$1,400. <http://www.huduser.org/Publications/pdf/EnergyEfficiency.pdf>

⁷⁵ The units are financed by HUD, but managed by 3,300 different Public Housing Authorities across the country.

- Promote workforce investment and green job training as an allowable cost under this fund in collaboration with the Department of Energy (Energy) and the Department of Labor (DOL) to establish streamlined training opportunities for community and PHA residents.

It is recommended that this Fund be capitalized at a level of \$13,320,000,000. The assumptions that lead to this level of funding are described below.

Retrofit	Funding Level	Description
General Retrofits	\$9,600,000,000	100% subsidy for 480,000 units @ \$20,000 per unit
Green Retrofits – Subsidized	\$3,600,000,000	100% subsidy for green retrofits for 75% of the 480,000 units @ \$10,000 per unit
Green Retrofits – ESCO Financing	\$ 120,000,000	10% guarantee fund (to leverage a total of \$1.2 billion from ESCOs, or other financing mechanism) for green retrofits for 25% of the 480,000 units @ \$10,000 per unit
Total HUD Cost	\$13,320,000,000	
Leveraged Capital	\$ 1,080,000,000	
Total Capital	\$14,400,000,000	

The following recommendations are made for strategies to retrofit HUD assisted housing units, including project-based Section 8, voucher-based Section 8, and Section 202 and 811 supported housing projects.

Recommendation 1.2: Project-based Section 8 retrofits

Short Term, New Funding

Increase Project-Based Section 8 operating expenditures by \$4 billion to retrofit 100,000 units. This would be a direct subsidy program (100% HUD funds with no leveraged capital). The cost per unit would average \$40,000 per unit, including \$10,000 for green retrofit features.

Recommendation 1.3: Section 202 and 811 project retrofits

Short Term, New Funding

Increase operating budgets by \$800 million to retrofit 20,000 Section 202 and 811 units. Similar to Project-Based Section 8 programs, this would be a direct subsidy program (100% HUD funds with no leveraged capital). The cost per unit would also average \$40,000 per unit, including \$10,000 for green retrofit features.

Recommendation 1.4: HOPE VI green housing projects

Short Term, New Funding

It is recommended that an additional \$100 million be invested for greening of existing HOPE VI projects that are in process and in need of additional resources to meet Energy Star and green community standards. The estimated cost per unit is \$10,000, and this amount of funding would allow the greening of 10,000 units over three years.

Recommendation 1.5: Energy efficient affordable Home Investment Partnerships (HOME) Grants

Short Term, New Funding

It is recommended that \$1.8 billion in additional funds for low-income home retrofits through the HOME block grant be provided.⁷⁷ HOME provides formula grants to states and localities that communities use – often in partnership with local nonprofit groups – to fund a wide range of activities that build, buy, and/or rehabilitate affordable housing for rent or homeownership or provide direct rental assistance to low-income people. Because HOME investments trigger code requirements, many of these projects may include green and general renovations.

Currently HOME projects leverage \$4 for every \$1 from HOME. (Historically, HOME has been combined with LIHTC funds which are much less available in current markets.) HOME also requires a 25% match of local dollars which may limit the ability to spend in the short term as city and state budgets are contracting. A \$2.1 billion investment could leverage an additional \$7.2 billion in private capital for a total capital commitment of \$9.0 billion.

⁷⁶ Energy Service Companies (ESCOs) are engineering firms that perform energy efficiency work and finance the projects using the savings in energy to pay back the capital investment of the project.

⁷⁷ This investment would complement an investment through the Department of Energy in the Weatherization Assistance Program. HOME is focused on multi-unit rentals, whereas WAP is primarily focused on single-family homes.

This would be sufficient to retrofit 300,000 units over three years, at an average cost of \$30,000 per unit (\$20,000 for general retrofit and \$10,000 for green retrofit features).

Recommendation 1.6: Green retrofits for lead hazard control homes

Short Term, New Funding

Homes that are already being retrofitted to eliminate lead hazards should also receive green retrofits. A total of \$150 million is recommended to do green retrofits for 15,000 lead abatement units over a three year time frame.

B. Regulations, Standards & R&D to Incentivize the Greening of Housing

Recommendation 1.7: Public Housing Authority retrofit incentives

Long Term, Existing Authority

It is recommended that new incentives for Public Housing Agencies to invest in retrofits be created. The following actions should be taken in this area:

- Allow housing authorities to retain 100% of their energy cost savings from green investments for 10 years.
- Restrict this provision to those investments made within the next 2 years to encourage early action. After that point, energy cost savings would still be retained at 100% for a 5 year period, to continue a strong incentive for conservation.
- The maximum term of a contract that a public housing authority may enter into with an energy services company under HUD's energy performance contracting authority was extended to 20 years from 12 years in the 2005 Energy Act. HUD must implement the regulations to enforce this extension.
- These investments would include commitments to purchase Energy Star appliances as well as identified green building and weatherization practices.

Recommendation 1.8: Community Development Block Grant (CDBG) Incentives

Long Term, New Funding, Existing Authority

As CDBG funding is returned to its historical levels, incentives should be provided to local governments to invest in greening their housing stock. As CDBG funding is restored, additional funding should be provided to local partners to invest in energy and water efficiency and green infrastructure strategies that are incorporated into their Consolidated Plans with performance goals.

Recommendation 1.9: Manufactured Housing

Short Term, Existing Authority

The HUD Office of Manufactured Housing should upgrade the manufactured housing construction code in coordination with the Federal Emergency Management Agency (FEMA) to be consistent with the International Energy Conservation Code (IECC) & improved environmental health standards while considering factory design and construction techniques, climate zone and cost-effectiveness. Additionally, the office should develop incentives for manufacturers to incorporate support for workforce training in their programs.

Recommendation 1.10: Green standards for new construction

Short Term, Existing Authority

HUD should seek clear authority from Congress to require all new construction to meet progressive green building standards.⁷⁸ (Applies to Public and Indian Housing [PIH] programs, Sections 202 and 811 programs, CDBG, HOME, and HOPE VI, among others.)

Recommendation 1.11: Increase total development costs (TDC) for green development

Short Term, Existing Authority

Green investment in new building projects should be encouraged by allowing projects to exceed total development cost limits by up to 7% to cover any "green premium." This green premium will provide an increased capital budget allowance dedicated specifically to green and energy saving investments, for a period of 5 years, because they will

⁷⁸ There are a variety of standards that can be used for this purpose, including the LEED Standards; Enterprise Green Community Standards; as well as regional variations such as EarthCraft House in Atlanta; SeaGreen Guidelines Seattle; and the Chicago Green Homes program.

result in on-going operational savings.⁷⁹

Recommendation 1.12: Building energy information systems and benchmarks

Short Term, New Funding, Demo Project

\$10 million should be invested in the development of sophisticated systems for measuring, tracking, and benchmarking energy costs in public and affordable housing programs.⁸⁰ The data system should be centralized and consider the public housing benchmarking model as an initial step.⁸¹ It should be used to establish performance benchmarks, track progress from retrofits and document savings, and prioritize retrofit investments.

Recommendation 1.13: Changing the way HUD pays for energy

Short Term, Existing Authority

Change the HUD budgeting process so that energy expenditures can easily be identified. Change the way that energy-related expenditures are provided in order to create energy-efficiency incentives for local housing authorities and individual building owners across all HUD programs. Announce a goal to reduce annual energy expenditures and associated greenhouse gas emissions.

Recommendation 1.14: Leadership in energy demand management (links to Recommendation 2.4)

Long Term, New Funding, Demo Project

\$50 million should be invested in HUD public housing and assisted portfolios to demonstrate state-of-the-art technology and practices in energy demand management. These demonstration projects could leverage utility resources to build the Smart Grid infrastructure. These strategies should include:

- *Smart Grid Demonstration.* HUD should implement smart grid technology in public housing units to demonstrate advanced strategies for energy efficiency and renewable energy. This involves the use of smart meters to track energy use by time of day, improved digital controls for managing energy demand, better information for customers, and safe, reliable integration of solar panels into the grid.
- *Real Time Pricing.* In regulatory markets where it is authorized, HUD should promote the use of real time pricing in its housing units and offer substantial consumer education to ensure that benefits are realized. This approach allows consumers to save on electricity bills by varying their usage according to real time prices.
- *Advanced Metering Technologies.* These include “next generation” automated meters, advanced software and communications technology, all of which enable customers to control their appliances, from hot water heaters to air conditioners, in response to real-time prices and conditions. In these systems, consumers can “see” their electricity use on in-home devices and over the Internet and can lower thermostats or turn off appliances at home or remotely when electricity rates are high.

STRATEGY 2 – Make HUD a Leader in the Development of the National Building Retrofitting Market

In addition to greening its own housing stock, HUD should take a national leadership role in promoting the “deep greening” of residential housing stocks across the country, and stimulating the development of a robust private national building retrofit market. Six sub-strategies are recommended in this area:

- The creation of a \$5 billion national Building Energy Efficiency Finance (BEEF) Fund.
- Creation of a national capacity building network of public agencies, non-profits, suppliers, contractors, workers, unions, and financial institutions to support regional retrofit strategies.
- Creation of a HUD Office of Sustainable Development.
- Investment in R&D to support development of the housing retrofit market.

⁷⁹ Recent studies have shown green building projects to cost an average premium of just under 3% of total development costs, with costs ranging from as low as 9% below to 18% above the cost of traditional construction. These investments however can provide near term paybacks for the cost of the initial capital investment and long term cost savings over the life of the project.

⁸⁰ According to the GAO study, HUD has partnered with Energy and EPA on the development of a system for public housing units, but they have not applied it to their privately managed assisted housing portfolio. The existing database is apparently the largest database of utility consumption of residential properties in the country, with over 4,700 properties from 160 housing authorities.

⁸¹ The GAO report, GAO-09-46, October 2008 on Green Affordable Housing.

- Development of a national informational and institutional infrastructure to aggregate carbon credits from the building energy efficiency market.
- Use of Fannie Mae and Freddie Mac and any housing bailout or urban economic recovery investments to stimulate the green housing market.

Recommendation 2.1: Building Energy Efficiency Finance Fund

Short Term, New Funding, Demo Project

A \$5 billion investment is recommended in a national Building Energy Efficiency Finance Fund to stimulate the development of the building energy efficiency retrofit market in communities across the U.S. Whereas the HUD-specific investments are focused on the retrofitting of subsidized housing units, the BEEF Fund would be focused on the non-subsidized segments of the housing market and units financed with the Low Income Housing Tax Credit (LIHTC). The Fund would engage in a number of activities designed to jump-start the building energy efficiency market nation-wide. These activities would include:

- *Provide planning grants* for regional retrofit market development strategies and institutions. These grants would be used for:
 - Baseline building stock analysis.
 - Baseline analysis of existing programs and resources.
 - Setting and prioritizing retrofit goals by segment and income levels.
 - Designing retrofit financial intermediaries.
- *Provide start up operating grants* for regional retrofit financial intermediaries. This capital would be used for:
 - Organizing the intermediaries, including legal structure and detailed business plan.
 - Initial operating expenses, such as staffing, legal services, marketing and outreach, etc.
 - Paying for energy audits, energy scoring systems, marketing and outreach and other costs of building the market.
- *Subsidize* retrofits for moderate and low income households that are not served under other government programs.
- *Provide risk mitigation capital and products* to leverage private capital into the “demand side” of the residential and commercial/industrial building retrofit market. These products could include loan guarantees, loan loss reserve funds, and government bond underwriting. This capital would be used to help building owners finance energy efficiency retrofits. It could be provided to regional intermediary institutions (including community development financial institutions [CDFIs], community loan funds, local units of government, ESCO financing entities, venture funds, utilities and others) as well as national partners.
- *Business investments.* Providing “supply side” capital to venture funds, loan funds and others to support the development and growth of contracting companies and other service providers to the building retrofit market.

The initial recommended level of funding for these categories is as follows:

Use	% of Fund	\$
Planning grants and start-up capital	10%	\$500 million ⁸²
Low income retrofit subsidies	45%	\$2.25 billion ⁸³
Capital leveraging	45%	\$2.25 billion ⁸⁴
Total	100%	\$5 billion

Additional detail on the proposed design of the BEEF Fund is provided in an attachment to this report.

Recommendation 2.2: Create a national technical assistance and capacity building network to support building retrofit strategies

Short Term, New Funding

HUD should take the lead in the creation of a national network of lead practitioners and experts to support regional strategies for accelerating the building retrofit market. This strategy could include:

⁸² This could, for instance, provide a total of \$10 million per region to 50 regions across the country, or an average of \$2 million of operating capital per region per year for 5 years.

⁸³ At \$10,000 per energy efficiency retrofit, this could subsidize retrofitting for 225,000 low-income households.

⁸⁴ At a leverage ratio of 10:1, this would leverage an additional \$22 billion in private capital.

- Creating a peer-learning and collaborative R&D network of the regions and cities that are implementing large-scale retrofit strategies. (These include cities like Chicago, Milwaukee, Cambridge, Portland, Seattle, Bay Area, Philadelphia and San Antonio.) The network would allow cities to learn from each other as well as collaborate on the development of key systems and standards to support market development.
- Create a network of Technical Assistance providers to work with regions implementing large-scale retrofit strategies.
- Increase the capacity of HUD regional offices to support large-scale retrofit strategies, and link to broader national commitments to job creation and national service through a Clean Energy Corps.
- Establish a program to make HUD buildings showcases for advanced green design, building codes, and green job programs for local construction markets.

Recommendation 2.3: Create a HUD Office of Sustainable Development

Short Term, New Funding

The new administration should create, or, if necessary, seek legislation to create an Office of Sustainable Development with the mandate to increase environmental sustainability in HUD-supported housing and community development projects and the larger real estate industry; consolidate HUD's environmental activities, including: enhance environmental review, promote healthy homes and lead hazard control, increase energy efficiency, remediate brownfields, promote green stormwater infrastructure and water efficiency; expand interagency collaboration to create greener communities by working with similar offices in other agencies (Energy, Transportation, Environment, Labor and Treasury); and ensure that sustainable homes, green infrastructure and communities are a priority in federal policy addressing energy, infrastructure, transportation and climate change. The Office should take the leadership role in advancing a national strategy to develop the private building retrofit market. It should also assist the Secretary to set performance standards linked to budget planning and performance review for all areas of HUD, including the Annual Performance Review and Management Plans, to ensure that environmental performance is internalized as standard operating procedure across the agency.

Recommendation 2.4: Invest in R&D to support market development (links to Recommendation 1.14)

Short Term, New Funding

Provide \$50 million to the Office of Policy Development and Research and its PATH (Partnership for Advanced Technology in Housing) initiative to support the development and implementation of the recommendations in the PATH Roadmap for Energy Efficiency in Existing Homes (Green-PATH Initiative). PATH's R&D activities can be demonstrated in recommendation 1.14.

Recommendation 2.5: Carbon credit aggregation infrastructure

Long Term, New Funding

Valuable revenues can potentially be aggregated from carbon credits on housing stock supported in one way or another by HUD.⁸⁵ However, carbon credit aggregation requires a set of systems and capacities that HUD currently lacks, including: accurate validation and measurement technology; compliance with offset protocols; third-party verification; resolution of legal issues on credit ownership; capacity for aggregation; and capacity for international credit trading. \$50 million should be invested in the development of a national infrastructure for building energy efficiency carbon credit capturing and aggregation. The dimensions of this initiative should include:

- Development of common standards for carbon credit measurement and verification.
- Design of information tools and systems for tracking carbon reductions from building retrofits.
- Business design for regional carbon credit aggregators and planning grants for their design and start-up.
- Building of a national network of carbon aggregation players for the built environment.

Recommendation 2.6: Use Fannie Mae and Freddie Mac to green the nation's housing stock

Long Term, Existing Authority

HUD should explore the ways in which green building standards could be leveraged to create incentives or boost the market to invest in energy efficiency. Examples include promoting Energy Efficient Mortgages and Location Efficient Mortgages®, also known as EEMs and LEMs, and the disclosure of energy costs and energy efficiency improvements during real estate transactions. All Fannie Mae / Freddie Mac financed projects should be required to purchase only

⁸⁵ For the City of Chicago Climate Action Plan, the total potential carbon credits from 12 years of residential and commercial/industrial energy efficiency retrofitting were estimated to exceed \$190 million in Chicago alone based on current carbon prices of \$8 - \$14 a ton.

ENERGY STAR appliances (for new construction or replacement) and meet certain green operations and maintenance standards for energy savings and improved resident health.⁸⁶

STRATEGY 3 – Locate Housing to Create Transit-Oriented, Walkable, Accessible Communities

HUD should take national leadership to assure that housing, transportation, and land-use goals are considered jointly and advanced to result in communities that are transit-oriented, walkable and accessible in order to reduce Vehicle Miles Traveled (VMT). Low-, moderate-, and middle-income families spend between 54 and 64% of their income on their combined housing, energy and transportation costs, often spending more on transportation than housing. Locating affordable housing within walking distance to affordable transit is essential so that lower-income families are able to save for their future or invest in education. Transit accessible affordable housing also provides families with greater employment and educational opportunities. The strategies below are some initial steps that can be taken and should be considered as part of a more comprehensive set of strategies to reduce combined housing and transportation costs.

Recommendation 3.1: Reward Location Efficiency

Long Term, Existing Authority

Require that building financed or insured by HUD be transit accessible or have a location efficient priority to the funding so that it contributes to reduced Vehicle Miles Traveled and reduced vehicle ownership.⁸⁷ Prioritize infill and provide resources for brownfield remediation by setting up a point system for new construction projects. Work with DOT/FTA to anticipate transit availability in developing affordable housing and in support of long term planning.

The scoring system could be based on a) likely reduction of VMT and vehicle ownership below area median, so that locations were reducing climate impacts and b) likely reduction of transportation costs, so that costs for the project's residents are reduced. (For example, any project within ½ mile of a rail/light rail/street car transit stop, or ¼ mile of a bus stop or public school/grocery store, will get more points.) New construction funding (from FHA and HUD) could only apply to projects that scored above a certain threshold. Over time, this score could be adjusted if there were more applicants than funding. Thus we would know that future projects would move development patterns and resident transit affordability in the right direction.

Recommendation 3.2: Raise total development cost (TDC) limits to promote more location efficiency

Long Term, Existing Authority

Currently, HUD TDC limits favor sprawl and limit more expensive urban development. For example, the base construction cost is multiplied by 1.6 for elevator buildings and 1.75 for non elevator buildings. TDC limits should be raised in urban areas to reflect local market costs so as to encourage infill, TOD and brownfield development. (This applies to PIH programs, Sections 202 and 811 programs, CDBG, HOME, and HOPE VI, among others.)

Recommendation 3.3: Redefine Affordability

Long Term, Existing Authority

For households earning \$50,000 or less, transportation now costs more than housing in most metropolitan areas, and this cost is highly dependent on the character of the location of housing.⁸⁸ The federal government should act to ensure that housing consumers (renters, homeseekers) and suppliers (investors, builders, regulators and developers) are made aware of the full direct costs of housing. Consider redefining the HUD definition of “affordable” housing to

⁸⁶ The Housing and Economic Recovery Act, passed in July and signed in August of 2008, tasks HUD with recommending a strategy for increasing the scale of EEM mortgage lending. HUD is preparing such a report for delivery in the early 111th Congress. In August 2008, the House Financial Services Committee passed HR6078, the GREEN Act, which would require affirmative actions by Fannie Mae and Freddie Mac and possibly by Ginnie Mae and the Federal Home Loan Banks, to take both EEMs and LEMs to scale.

⁸⁷ Center for Neighborhood Technology and Center for Transit Oriented Development, “The Affordability Index: A New Tool for Measuring the True Cost of a Housing Choice,” Brookings Institution, 2006 at http://www.brookings.edu/reports/2006/01_affordability_index.aspx; geocoded data for 54 metropolitan regions and map server available at <http://htaindex.ent.org>.

⁸⁸ Barbara J. Lipman and others, “A Heavy Load: The Combined Housing and Transportation Burdens of Working Families,” Center for Housing Policy, 2006; and Carrie Makarewicz and others, “Estimating Transportation Costs for Households by Characteristics of the Neighborhood and Household,” *Transportation Research Record*, 2008

take into account not only the cost of the housing, but also the cost of transportation and energy associated with that housing, without disadvantaging rural housing.

STRATEGY 4 – Under White House Leadership, Organize a Cross-Department National Strategy for Green Building Retrofits as an Economic Sector Development Strategy

The development of a serious strategy to jump start the national building retrofit market and realize the untapped market opportunity for building efficiency savings will require integration of multiple initiatives across the entire spectrum of the federal government, and will extend far beyond the influence of HUD alone. In particular, it will require coordination from HUD, the Department of Commerce (DOC), the Department of Labor (DOL), the Department of Energy, the Small Business Administration (SBA), the Environmental Protection Agency (EPA), Transportation (DOT), and Treasury to coordinate the combination of housing strategies, economic development and business development support, workforce development and job training, energy standards and grants, environmental programs and tax credits. It is critical that this initiative be looked at from the national market perspective, and not from the perspective of individual federal departments and agencies. And it is also critical that this initiative take a distinctly regional perspective and engage regional political leadership in its design – since it is at the metropolitan and regional level where the “parts” need to be integrated into a “whole” that can have the desired catalytic effect. The following strategies are recommended in this area.

Recommendation 4.1: Energy Efficiency and Conservation Block Grants (EECBG)

Short Term, New Funding, Existing Authority

The authorized but un-funded EECBG should be fully funded at a \$10 billion level, and HUD should partner with the Department of Energy on the use of the EECBG to support the development of regional strategies for stimulating the building retrofit market. In particular, HUD and Energy should partner on the provision of sophisticated technical assistance support to regions to make sure their strategies are market-building strategies and not just public programming.⁸⁹

Recommendation 4.2: Green jobs and service for public housing residents

Short Term, Existing Authority, Demo Project

Public and affordable housing residents should be provided with an accelerated program for accessing green job training and should directly benefit from the transforming of the nation’s affordable housing stock into a laboratory for green building innovation, distributed energy generation, and energy efficiency. Specifically, the HUD Secretary should engage DOL in the development of Green Jobs training programs that connect affordable housing residents to green career pathways and create a priority for qualified public housing residents to be employed in the retrofitting contracting process. This effort should be linked directly to full funding and implementation of the Green Jobs Act at \$500 million, to engage existing workforce development, apprenticeship programs, and community-based service organizations in job training in energy efficiency and clean energy retrofits. In addition, HUD should work actively as a leader in interagency processes (with DOL, Energy, Treasury, and the Corporation for National Service) to establish a national Clean Energy/Green Jobs Corps and supporting funding mechanisms. The goal is to link national service goals and President Obama’s commitment to create 5 million new jobs, to the expanding need for energy retrofits in our built infrastructure, and HUD’s ability to drive regional market transformation.

Recommendation 4.3: Residential energy efficiency tax credit

Short Term, Existing Authority

Funding for refundable residential energy efficiency tax credits should be increased to \$5 billion and the maximum credit for household efficiency upgrades should be increased to \$2,000.

⁸⁹ Eligible activities of the Energy Efficiency and Climate Protection Strategy are heavily weighted towards energy efficient housing. These activities include: determination of 1990 and present levels of GHG emissions; conducting energy audits and weatherization programs; creation of financial incentive programs for energy efficiency retrofits; development and implementation of building and home energy conservation programs; development and implementation of building codes and inspection services for public, commercial, industrial and residential buildings to promote energy efficiency; development and implementation of transportation fuel conservation programs; development and implementation of alternative fuel technologies and infrastructure that result in significant GHG emission reductions; and development and promotion of land use guidelines that result in energy efficiency and GHG emission reductions.

Recommendation 4.4: Build National Capacity to Serve the Building Retrofit Market

Long Term

In addition to the task of stimulating demand for building retrofits through direct subsidies, finance instruments, and regulatory incentives or requirements, there is also a huge task of building the capacity of the market to effectively respond to this demand. The contractor, supplier and workforce capacities do not currently exist to serve an increase of this market in the \$100 billion+ range. HUD's existing grantees will need assistance to expand their current initiatives. Developing this capacity will require investing in supply chain development, which will need to be done across multiple parts of the federal government, and in collaboration with regions. The elements of this will include:

- Career pathways; education and adult workforce development to create an integrated “human talent supply chain” for the building retrofit market.
- National standards on contractor and professional certification. (Many of these are already in place.)
- Business development support for contractor development – both creation of new contractors and expansion of capacity in existing contractors.
- The national supply of energy auditors and certifiers.
- Technical assistance to HUD grantees and regional support networks.

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ADDENDUM 9.1

BUILDING ENERGY EFFICIENCY FINANCE FUND

This document provides an additional level of detail on one of the recommendations made by a voluntary team to the U.S. Department of Housing and Urban Development (HUD) transition staff on how to “green” the HUD housing stock, and use HUD to stimulate the development of a robust national green building retrofit market that will result in the energy efficiency retrofitting of a substantial percentage of the nation’s building stock.

One of the recommendations of this team was the creation of a \$5 billion Building Energy Efficiency Finance (BEEF) Fund. This document provides some additional details on how this fund might operate.

A. Fund Purpose: To stimulate the development of the national building energy efficiency retrofit market.

The Fund would serve as a “national green housing retrofit investment bank” – whose purpose is to catalyze the private market for energy efficiency building retrofits. We believe that this market is ripe for development – and that a well-capitalized national investment fund could significantly accelerate its development.⁹⁰ If 50% of the 128 million housing units nationwide were retrofitted at the modest rate of \$10,000 per unit, this would be a market worth over \$600 billion in revenues. Stimulating a market of this size will require a “market-making” institution that can make several different kinds of smart investments, as well as bring together many of the key players in the market to build the market infrastructure (information products, standards, supply chain, specialized intermediaries, etc.) need to have the market be self-sustaining over time.

B. Fund Activities:

The Fund would engage in a number of activities designed to jump-start the building energy efficiency market nationwide. These activities would include:

- Provide planning grants for regional retrofit market development strategies and institutions. These grants would be used for:
 - Baseline building stock analysis
 - Baseline analysis of existing programs and resources
 - Setting and prioritizing retrofit goals by segment and income levels
 - Designing retrofit financial intermediaries
- Provide start up operating grants for regional retrofit financial intermediaries. This capital would be used for:
 - Organizing the intermediaries, including legal structure and detailed business plan.
 - Initial operating expenses, such as staffing, legal services, marketing and outreach, etc.
 - Paying for energy audits, energy scoring systems, marketing and outreach, and other costs of building the market
- Provide partial subsidies of retrofits for moderate income households.
- Provide risk mitigation capital and products to leverage private capital into the “demand side” of the residential and commercial/industrial building retrofit market. These products could include loan guarantees, loan loss reserve funds and government bond underwriting. This capital would be used to help building owners finance energy efficiency retrofits. It could be provided to regional intermediary institutions (including CDFIs, community loan funds, local units of government, ESCO financing entities, venture funds, utilities and others), as well as national partners.

⁹⁰ A wide number of large urban centers (Chicago, Milwaukee, Portland, Seattle, Philadelphia, San Antonio, and the Bay Area, among others) are in the process of putting together regional strategies and regional institutions to build their local retrofit markets. The Fund could provide crucial support to these kinds of efforts.

- Business investments. Providing “supply side” capital to venture funds, loan funds and others to support the development and growth of contracting companies and other service providers to the building retrofit market.

The initial recommended level of funding for these categories is as follows:

Use	% of Fund	\$
Planning grants and start-up capital	10%	\$500 million
Moderate income retrofit subsidies	45%	\$2.25 billion
Capital leveraging (split 70/30 between demand side and supply side)	45%	\$2.25 billion ⁹¹
Total	100%	\$5 billion

C. Funding Process:

The Fund would distribute its capital on a competitive bid basis. Preference would be given to large-scale integrated regional strategies based on a business plan that demonstrates analysis of the existing building stock and retrofit programs as well as the setting of clear goals for deep market penetration rates by segment. Preference would also be given to strategies that demonstrate coordination and collaboration with local/regional green workforce development systems and other potential sources of building retrofit financing, such as weatherization assistance, Community Development Block Grants, public housing retrofit strategies, Energy Efficiency Block Grants, etc.

D. Fund Structure:

There are a number of options for structuring the Fund. These include the following:

- *Government Administered Fund.* Structuring the Fund in a fashion similar to the Community Development Financial Institutions Fund (CDFI Fund) in the Department of Treasury that allocates a combination of capital and New Market Tax Credits to CDFIs and other Community Development Entities.
- *Existing Intermediary.* Providing the capital to an existing housing finance intermediary and using it [b/c both <<capital>> and <<intermediary>> are singular] to make the fund investments.
- *New Federally Owned Investment Bank.* Creating a new federally owned investment corporation (“green infrastructure investment bank”) to carry out the tasks of the fund. The corporation would be capitalized with the \$5 billion in proposed capital investment. (This would be a structure similar to the Alaska Permanent Fund.)
- *Capitalize a New Private Fund.* An RFP process could be used to capitalize a new “double bottom line” investment fund that is organized by private investment managers and carries out the multiple functions of the fund. The federal government would be the key investor in the fund, but the fund would be expected to also raise private capital.

Our instinct is that the Fund would best be structured as a free-standing investment entity outside of the federal government. While there are multiple pathways to launching such an entity, the most efficient market strategy would probably be to use an RFP process to capitalize a new investment fund organized by private investment managers with experience in national real estate markets.⁹²

Whatever structure is chosen for the fund, it would have to be capable of carrying out the multiple functions of the Fund, including:

- Allocating planning grants.
- Allocating regional intermediary start up grants.
- Allocating capital to regions for subsidizing low income retrofits.
- Making investments in national and regional retrofit financing intermediaries designed to leverage private capital.

⁹¹ At a leverage ratio of 10:1, this would leverage an additional \$22 billion in private capital.

⁹² There are many examples of such “multiple-bottom line” investment funds. See “The Double Bottom Line Handbook”, available at www.sdsgr.com, which documents over \$10 billion of investment in such funds.

- Bond underwriting for local and state government building retrofit bonds.
- Capital for development and growth of contractors serving the retrofit market.

This would likely require an umbrella structure housing several different kinds of functions and/or funds. Given that the purpose of the fund is to help develop the national energy efficiency retrofit market, not just subsidize transactions, one could imagine the Fund having a number of different sub-units:

- Regional strategy unit (allocating planning grants and regional intermediary start-up grants, as well as general Technical Assistance to the field).
- Industry outreach (working with the building and contracting sector to develop standards, information resources and other tools to advance the sector).
- Subsidized retrofit grants (making grants to regions to subsidize housing retrofits for low and moderate income housing that does not qualify for other subsidies).
- Private capital fund (to leverage private investment into the green retrofit market).
- Business development fund (to invest in financial institutions, funds and other capital providers serving contractors and other building retrofit service providers).

The Fund would need to work in close collaboration with other players in this sector and, to this end, would likely be engaged in significant outreach and networking.

E. Leveraging Private Capital:

The Fund would leverage private capital in three different ways:

- The moderate income subsidies would be restricted to, on average, one-third of the total cost of a retrofit. In this case, the fund would be leveraging private building owner capital on a 2:1 ratio (\$1 of fund subsidy would be matched by \$2 of private building owner investment). In other words, the \$2.25 billion in partial subsidies would be matched by \$4.5 billion in private capital, for a total investment of \$6.75 billion.
- The “demand side” capital would be used as risk mitigation to attract private capital investment in retrofit transactions that have attractive energy savings ROIs (both residential and commercial/industrial). The leverage ratio in the retrofit market will depend on a combination of: 1) the degree to which the market returns to “normal” levels of liquidity (this is assumed for purposes of this fund); and 2) the risk perception of this market by private investors. For purposes of this fund, we assume that the risk levels will be somewhat higher than traditional economic development finance tools, so we assume a risk level of 10%, for a leveraging ratio of 10:1. Assuming 70% of the \$2.25 billion risk mitigation capital is committed to demand-side leverage, this would mean a total of \$1.575 billion, leveraged at a rate of 10:1, resulting in a total investment of \$15.75 billion.
- The “supply-side” capital would be invested in loan funds, venture funds and other sources of capital to support companies providing products, services and technology to the high-performance building market. Thirty percent of the \$2.25 in leverage capital (\$675 million) would go to this purpose.

Here are some of the kinds of transactions the fund could engage in to leverage private capital into this market.

- The Fund invests in a regional building retrofit financing intermediary, providing capital for loan guarantees on both residential retrofits as well as commercial/industrial Energy Service Company (ESCO) transactions.
- The Fund capitalizes a loan loss reserve fund for the financing facility for a national home retrofit company, such as Home Depot or Sears.
- The Fund capitalizes a loan loss reserve fund in partnership with a national community development bank.
- The Fund underwrites a bond for a state program for a loan loss reserve fund for ESCO transactions with state and municipal buildings.
- The fund invests in a series of venture funds specializing in the retrofit contractor market and/or product and technology innovations for the retrofit market.

F. Fund Payout Scenarios:

After establishment, the rate of actual capital payout from the fund will be determined by a number of factors:

- Readiness of regions to implement large scale retrofit strategies.
- Rate at which intermediary start up occurs.
- Rate at which private capital partners are brought on board and develop deal flow.
- Ability to stimulate home owner demand for green retrofits.
- Capacity of programs to deliver subsidized retrofits.
- Degree to which supply chain constraints slow down implementation.

One possible scenario for payout over 10 years is provided below.

Building Energy Efficiency Finance Fund Payout Scenarios											
(in millions of \$)											
Fund Use	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Regional Planning Grants	\$5	\$15	\$15	\$15							\$50
Start Up Capital Grants	\$10	\$30	\$80	\$100	\$120	\$60	\$50				\$450
Low Income Subsidies	\$280	\$350	\$700	\$700	\$210						\$2,240
Private Leverage	\$50	\$100	\$400	\$400	\$300	\$200	\$200	\$200	\$200	\$200	\$2,250
Total Pay Out	\$345	\$495	\$1,195	\$1,215	\$630	\$260	\$250	\$200	\$200	\$200	\$4,990
Subsidized Units Per Year	80,000	100,000	200,000	200,000	60,000						640,000
Total Leveraged Funding	\$500	\$1,000	\$4,000	\$4,000	\$3,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$22,500
Units Per Year Financed With Leveraged Capital	50,000	100,000	400,000	400,000	300,000	200,000	200,000	200,000	200,000	200,000	2,250,000
Total Capital	\$795	\$1,395	\$4,795	\$4,815	\$3,330	\$2,060	\$2,050	\$2,000	\$2,000	\$2,000	\$25,240
Total Units	130,000	200,000	600,000	600,000	360,000	200,000	200,000	200,000	200,000	200,000	2,890,000

The assumptions that this payout is based on include the following:

- Planning grants average \$300K per region, and a total of 160 grants are given out over four years (some regions might receive more than one grant). (If the top 125 metro regions in the country received at least one grant, that would encompass a total population of over 200 million people.)
- Start up capital grants average \$10 million per region over 5 years, for \$2 million per year per region. In this scenario, a total of 45 regions end up qualifying for 5 years worth of grants (\$10 million per region).
- Low income subsidies are released over 4 years, and the average cost of a unit is \$10,000 per year, with \$3,500 per unit subsidized.
- Private leverage capital is released over the full 10 years of the fund, with the largest amount in years 3 and 4. Leverage is on a 10:1 basis.

CHAPTER 10

CATALYZING CHANGE AT HUD: BUILDING A MORE EFFECTIVE DEPARTMENT

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

This report provides recommendations for changing the way the U.S. Department of Housing and Urban Development (HUD) operates to help the department become more effective and impactful. It identifies:

- Why organizational change is needed at HUD.
- Core principles for “catalytic government” – a framework for open, enabling, strategic, results-oriented government that we applied to develop recommendations for how HUD could become more effective.
- Recommendations for action in the short- (within 90 to 180 days) and medium- (within first year) terms.
- Leadership requirements for transforming HUD.

In short, we lay out a case and initial agenda for *organizational* transformation of HUD. The Secretary’s personal, visible, and sustained leadership in championing such an undertaking is essential to its success.

INTRODUCTION

A. Why organizational change is needed at HUD

These are three key reasons why the Secretary should be concerned with the need for organizational change at HUD:

- *First and foremost, the nation needs HUD to step up and play a strong leadership role in executing and coordinating the national response to today’s pressing housing and community development challenges.* On issue after issue, HUD has ceded leadership to other agencies that have a role in areas relevant to housing and development issues, but which lack the special commitment to strong families and strong communities that HUD brings. Examples include rising foreclosures (Treasury and Federal Deposit Insurance Corporation [FDIC]), the implications for housing of rising energy prices (Departments of Energy and Transportation [DOT] and the Smart Growth Office of the Environmental Protection Agency [EPA]), the housing needs of communities impacted by disasters (Federal Emergency Management Agency [FEMA]), and the production of affordable rental housing (Internal Revenue Service [IRS], as administrator of the Low-Income Housing Tax Credit [LIHTC]).
- *Second, many partners experience HUD as more of an obstacle than a contributor to progress at the local level.* One commonly repeated refrain is, “We wish HUD would just get out of the way!” There can be no more powerful indictment for an agency charged with helping to strengthen families and communities. In our view, it reflects the predominance of HUD’s role as an enforcer of rules and regulations, rather than an enabler and catalyst for positive change.
- *Third, major changes are needed in HUD’s mission, structure and systems to ensure that HUD can fulfill its critical functions in a changed world.* Effective and attentive leadership at HUD should help to boost staff morale and instill more of a “can-do” attitude. But this alone will not solve HUD’s fundamental challenges, which include: the lack of a clearly defined and achievable mission; the failure to understand and design approaches that capitalize on HUD’s “value-added” in a world of devolution; and the lack of capacity in many of the areas needed to meet current challenges.

This report provides initial recommendations on how to approach this change in 2009 at HUD. As noted below (p. 190), we believe these recommendations should serve as the foundation for a deeper and more detailed plan to transform HUD that would be developed and implemented from 2010 on.

B. Core Principles for “Catalytic Government”

Among the many things the leader of an organizational transformation must do to mobilize the entity’s employees and stakeholders is to articulate a set of organizing principles that guide change. We developed our recommendations by applying four principles of catalytic government – a blend of “reinvention” approaches and an Obama-style, bottom-up and inclusive approach – to the specific challenges facing HUD. Briefly stated, the four principles are:

Principle 1: Government that enables.

While HUD cannot ignore its responsibility for enforcing federal statutes and regulations, it also cannot let this role so dominate its overall approach that it becomes an obstacle to progress, rather than an enabler. In our view, it is essential that HUD focus more attention on *enabling progress at the state and local level*. To this end, HUD needs to better understand and appreciate its “value-added” role at the state and local levels and then build out its capacity to play this role more effectively.

Principle 2: Government that is open, transparent, and responsive.

Like many bureaucracies, HUD can be insular, secretive, and in insufficient contact with the practitioners and other stakeholders that use HUD programs to achieve positive change. By opening up the agency to regular and meaningful contact and exchange with the full range of its constituencies – both through meetings and through electronic communications – HUD can learn how to better meet its partners’ needs.

Principle 3: Government that is results-oriented.

Like all federal agencies, HUD is required to report on its performance under the Government Performance and Results Act. HUD staff devotes an enormous amount of time and energy to complying with the requirements of this Act, yet the performance information generated is seldom used as a real management tool. HUD needs to identify a more limited set of goals and standards that it will actually use to manage its affairs and hold itself and others accountable.

Principle 4: Government that is strategic.

HUD needs to become more strategic in how it approaches its work. Right now, HUD feels principally like a collection of miscellaneous programs, organized loosely around the themes of affordable housing and community development. There is obviously a good historical explanation for this – HUD’s programs were created over a long period of time by different Administrations and Congressional leaders – but the effects of this non-strategic approach are preventing HUD from reaching its potential as a facilitator and enabler of progress at the local level.

Without a clear strategic vision that explains what HUD’s “value added” is and what HUD ultimately seeks to achieve, the program offices tend to focus on the most pressing of their mandates – enforcement of HUD laws and regulations – rather than on achievement of HUD’s substantive goals. The lack of vision also helps explain why collaboration between programs and agencies is not highly valued; if there’s no higher goal to which one is aspiring, why engage in the difficult work of collaboration?

Embedded in these principles is a vision of HUD operating in the not-too-distant future as *a value-adding, engaged, and accountable partner with local, state, and federal practitioners and stakeholders across the nation*.

An earlier version of this report, prepared for the Transition Team, focused on a series of transformational approaches to organizational change that we have applied in conjunction with these principles of catalytic government in developing our recommendations. To simplify this report, we do not offer those approaches as a parallel organizing framework for our recommendations. However, it may be useful to note that the recommendations that follow rely heavily on these transformational approaches, which include: *strong leadership by the HUD secretary* (top-down); *strong engagement with outside constituencies* (outside-in); *input from HUD employees* (bottom-up); and *inter-office and inter-agency collaboration* (cross-cutting).

RECOMMENDATIONS FOR ACTION

We list below a series of recommendations that we have developed to implement and apply the principles of catalytic government. We have organized these recommendations according to four categories that roughly correspond to the steps that an organization would take in developing a strategic plan. This is not to say that this report comes anywhere close to outlining a new strategic plan for HUD. But it does identify opportunities for short- and medium-term progress in each of these areas that could help lay the groundwork for a more fundamental transformation plan.

The four organizational categories are:

- A. Mission Articulation:** Updating HUD’s mission to reflect current challenges.
- B. Strategic, Program and Product Alignment:** Clarifying the “value added” of HUD and implementing appropriate approaches to delivering this value.
- C. Structural Redesign:** Structural changes within the organization of HUD that could help HUD better achieve its mission and deliver its value-added.
- D. Systems Development:** Process and data improvements that would help HUD better achieve its mission and deliver its value-added.

Each recommendation is classified as either short- or medium-term:

Short-term actions (to be taken in the first 3-6 months): These actions tackle immediate “hot spot” issues; send important change signals to constituencies; and/or put in place essential building blocks for long-term change.

Medium-term actions (to be taken in first year): These actions build on short-term actions and expand the transformation effort.

We believe these recommendations should serve as a foundation for a deeper, more detailed plan to transform HUD that would be developed early in this term and include a more systemic approach to each of the four categories addressed here (mission articulation, program and product alignment, structural redesign, and systems development), as well as the fostering of a widespread “can do” organizational culture in Washington and the field offices. Many ideas have been raised for more fundamental changes within HUD – for example, some have proposed reorganizing of responsibilities among HUD HQ Offices or spinning off various HUD functions to independent corporations – that merit full consideration in light of the mission and vision developed during this initial period.

The following are our recommendations for initial steps during 2009 to get HUD back on track and in a position to develop a longer-term plan for transformation.

A. Mission Articulation

Recommendation 1: HUD should clarify and update its mission to enable HUD staff and partners to better understand HUD’s role and guide current and future policy development.

The world has changed considerably since HUD was established, and new housing and community development challenges have arisen. One of the most important questions facing HUD is whether to update and expand its mission to focus on the broad set of housing and community and economic development challenges now facing the country. The answer to this question will impact the other issues addressed by this report, including HUD’s program alignment, structure, and systems development.

Despite its substantial financial and information resources and nationwide presence, HUD remains a marginal player on many of the most vital housing problems facing the nation. These include the foreclosure crisis, the implications for housing of rising energy prices, the specialized housing needs of the rapidly increasing number of older Americans, disaster preparation and response, the growing housing challenges facing working families, etc. A similar argument could be made about HUD’s positioning in the nation’s community and economic development challenges, where the agency has done little to help local communities address the emerging and powerful regional dynamics that establish a new and different context for community prosperity and sustainability. On other key issues – such as the continuing geographic concentration of low-income households – HUD programs are both part of the problem but

also potentially part of the solution.

If HUD chooses to take on an expanded mission in a meaningful way – and we think it should⁹³ – have to determine how best to execute it without undermining its long-standing commitment to meeting the pressing housing needs of the poor. This will require new and innovative approaches, including many of the value-added strategies discussed elsewhere in this report (research, technical assistance, incentives, etc.), as well as structural changes in how HUD allocates and organizes its staff.

Below are two initial big-picture recommendations for implementing this expanded vision for HUD. Both have applications in the short- and medium-terms. Other recommendations are included in the next two sections (program alignment and structure) of this report.

Recommendation 1.1: HUD should stimulate the incubation of new ideas on how HUD and state and local communities can more effectively respond to key long-term housing and urban development issues, such as rising energy prices, the growing population of older Americans with specialized housing and services needs, the housing challenges facing working families with incomes that generally exceed the level targeted by HUD programs, disaster preparation, etc. HUD should use the tools discussed in the next two sections – collection and dissemination of information on effective practices, research demonstrations, use of financial and regulatory incentives, interagency task forces, etc. – to incubate these ideas.

Recommendation 1.2: HUD needs to expand its expertise on the core housing challenges facing the nation. HUD has developed specialized expertise on its own laws and regulations, but lacks expertise on housing and community and economic development policy more broadly. HUD needs to identify and rectify its staffing deficiencies on each of the nation’s pressing housing and urban development problems and recast the job descriptions of these experts to focus on developing more effective strategies for meeting the actual housing and urban development problems, rather than simply on the generally narrow role of HUD programs in addressing those problems. HUD further needs to build much closer relationships with outside organizations that have or could easily build the necessary expertise and determine how best to deepen and leverage that expertise for the benefit of the nation.

B. Program and Product Alignment

Recommendation 2: To remain relevant in this era of devolution, HUD needs to develop new ways of influencing the activities of state and local governments.

HUD has not adapted effectively to the devolution of authority from the federal to the state and local levels that has taken place over the past thirty years. Some programs – notably public housing and the Section 8 voucher program – remain highly (and, some would argue, over-) regulated. Other programs – notably Home Investment Partnerships (HOME) and the Community Development Block Grant (CDBG) – provide state and local government with more flexibility but, in doing so, virtually abdicate any federal role at all other than processing the awards and monitoring fraud.

The world has changed in ways that HUD needs to better understand and process. For example, much of the innovation in affordable housing and community development is now happening at the state and local levels, but HUD is still focused almost entirely on the rules and regulations of its own programs that form only a small piece of most affordable housing and community development deals. HUD needs to gain a better understanding of how its programs relate to the broader set of tools available to state and local governments and consider how HUD can help states and localities respond more effectively to the housing and community development challenges that they face.

To respond effectively to these challenges, HUD needs to learn how to exert influence by “adding value” to local decision-making – through incentives, for example, rather than new requirements, and by developing and sharing expertise on how to design and execute more effective housing and urban development strategies at the state and local level. HUD also can help by developing unique data/information products and through the convening and

⁹³ The Task Force on Extending HUD’s Urban and Regional Mission has recommended that HUD’s mission be revised to include the phrase, “to foster decent homes and livable communities in economically strong and environmentally sustainable metropolitan regions.”

mobilization of stakeholders to impact local conditions. This does not mean that HUD should give up on regulation and performance standards; certain issues – such as housing-quality standards and, potentially, energy-efficiency standards – will always be addressed most effectively through regulatory requirements. But HUD needs to develop an ability to influence outcomes through such non-regulatory processes as catalytic research and information products, identification of best practices and tested innovations, technical assistance, and regulatory and financial incentives. To this end, we recommend the following:

Recommendation 2.1: HUD should charge the Assistant Secretary for Policy Development and Research (PD&R) with the task of developing a strategic plan for how HUD will build and disseminate knowledge about effective state and local housing and community and economic development strategies (short-term).

These strategies should focus on meeting state, metro area, and local needs, and not simply on HUD programs. The aim should be to assemble the best-available knowledge base and develop a series of channels for effectively disseminating this information – including online guidebooks and forums, conferences and trainings, and direct technical assistance. Because there is a great deal of expertise on these issues within the industry and at the state and local level, HUD should strive to build on existing efforts rather than reinvent the wheel. Executing this function by augmenting and coordinating the efforts of partner institutions should be strongly considered.

Recommendation 2.2: HUD should provide funding in HUD’s FY 2010 budget to allow PD&R to hit the ground running in executing this strategy. Funding should also be included in the FY 2010 budget of the Office of Community Planning and Development (CPD)⁹⁴ for a more expansive form of technical assistance (short-term) to state and local grantees that goes beyond the narrow rules of HUD’s programs to help them solve their housing and community and economic development challenges.

Recommendation 2.3: HUD should use the FY 2011 budget process to develop and introduce a limited number of financial and regulatory incentives to achieve core Administration outcomes (medium-term). Tangible rewards for achieving such Administration priorities as improved energy-efficiency and proximity to public transit and job centers would help shape how states and localities use both federal and locally-generated funds.

Recommendation 2.4: HUD should actively compile and then implement regulatory or sub-regulatory incentives to achieve key policy goals that do not require congressional actions. In many cases, rather obscure rules can have a big impact. For example, state and local practitioners report that the burden of accounting for so-called “program income” in the HOME program acts as a disincentive for jurisdictions to recycle the funds to help future generations of homebuyers. HUD clearly ought to be incenting rather than discouraging the preservation and recycling of subsidy. While some fixes to this problem might require Congressional action, others may be implementable by HUD directly.

Additional suggestions for adding value to state and local decision-making.

The following are some specific ideas for how HUD could add value to local decision-making that should be considered by HUD in developing the strategic plan referenced above.

Recommendation 2.5: HUD should team with social-innovation organizations such as the Ashoka and Skoll Foundations and with the Kennedy School’s Innovations in American Government Awards Program, to conduct prize competitions to identify the most promising feasible, sustainable, and scalable innovations for community and urban development (medium-term). Competitions with significant financial prizes succeed in drawing in ideas from a great diversity of sources. The entries are vetted by experts and tested for their potential. Winners are typically given awards, publicity, and opportunities to implement their ideas. These contests generate enormous amounts of information about innovations and they honor social innovators. A first round of prize competitions could focus on:

- Strengthening local civic engagement by low-income individuals and neighborhoods.
- Ways to help low-income parents seeking to improve their children’s education – by selecting their school; participating in school-based learning activities; and organizing out-of-school learning activities.

⁹⁴ The Task Force on Extending HUD’s Urban & Regional Mission has recommended that this position be renamed the “Assistant Secretary for Urban, Regional, and Community Development.”

Recommendation 2.6: HUD should support the development of an online Workforce Housing Resource Center to increase the knowledge base of workforce housing providers across the country and facilitate the sharing of information among and between them (medium-term) by building on or supplementing such existing resources as HousingPolicy.org, PolicyLink’s Equitable Development Toolkit, and the best practices resources of Business and Professional People for the Public Interest (BPI) (www.bpichicago.org).

The Center could create a ‘social network’ through which workforce housing providers can share information; collect, organize and disseminate lessons learned from the field; analyze, distill and disseminate information from relevant federal, state and local programs; provide online training on critical workforce housing delivery issues; establish forums for collective discussion and analysis of innovative approaches to key issues: finance, land acquisition, rehabilitation of existing facilities, planning and design, construction, etc. The Center should provide practical, evidenced-based information that housing providers can directly use in their work, with the overall goal of increasing the quality and the supply of workforce housing through a better understanding of strategies that have proved successful in the field.

Recommendation 2.7: HUD should deploy an Internet-based iCommunity Video Network for citizen-generated video news (medium-term), using existing video services such as YouTube, to share information and learning about housing and community development related to HUD and other state and federal projects.

Recommendation 2.8: HUD should consider using its information technology resources to host interactive communities (medium-term) where local officials could learn from each other how such topics as how to re-circulate second generation Empowerment Zone loans and neighborhood and other organizations could exchange best practices about, for instance, protecting vacant foreclosed properties.

Recommendation 3: HUD should develop a “flexible performance partnership” with public housing agencies.

In contrast to the Office of Community Planning and Development, which has largely given up influencing how grantees use CDBG (and, to a lesser extent, HOME) funds, the Office of Public and Indian Housing appears to suffer from the opposite problem. In the public housing and voucher programs, highly prescriptive regulations lead to a climate in which agencies spend a tremendous amount of time on compliance, and have less ability to respond creatively to the challenges they face. To address this problem, we recommend the following:

Recommendation 3.1: HUD should establish a national advisory group of Public Housing Agencies, tenant and housing advocates, and HUD staff to recommend the design and expansion of “flexible performance partnerships” between HUD and state and local housing authorities (short-term). Many local and state housing agencies perceive HUD to be overly regulating their actions, creating bureaucratic inefficiencies in reporting and high levels of rigidity that stifle innovation. These partners will best achieve HUD’s broader goals when HUD establishes clear outcomes, requires a relatively small set of rules, and allows for broad flexibility in achieving those outcomes, or when HUD offers local partners the option of proposing *locally* desired outcomes, aligned with HUD’s goals, which HUD can then approve and support. Flexible performance agreements should include clarity about what results are desired – clear definable indicators or metrics; flexibility about how to accomplish the particular results; and accountability for the entity’s performance. The advisory group should examine the experience of HUD’s “Moving to Work” demonstration, which allows public housing agencies to have broad budget authority and relaxed supervision, and how it illuminates the benefits and challenges of performance flexibility.

Recommendation 4: HUD should use major research demonstrations to catalyze innovation.

As New York City is demonstrating through its rigorous evaluation of recommendations developed through the City’s Commission for Economic Opportunity, there is a tremendous need to develop a stronger knowledge-base about what strategies are most effective for expanding the availability of affordable housing and catalyzing community and economic development. This will require a much larger budget for research and a different approach to research – for example, emphasizing large-scale rigorous research demonstrations that definitely answer key questions over smaller descriptive projects. While a budget of \$100 to \$200 million per year for research may sound like a lot of money compared with the roughly \$10 million per year that HUD currently spends (not counting the American Housing and other census surveys), it is a fraction of what a private corporation with a comparable budget would spend on R&D

and, ultimately, a small investment compared with the benefits of making \$35 billion per year of programs much more effective.

To this end, we believe that *HUD should propose and execute a series of major research demonstrations to test new ideas for improving its programs and helping state and local governments develop more effective housing and community and economic development strategies (short- and medium-terms)*. The collection and dissemination of information on best-practices, while valuable, can only take one so far. At some point, rigorous evidence is needed to help communities make better decisions and to help HUD strengthen its programs, and this requires both vision and resources. The following are two specific examples of demonstrations worth considering:

Recommendation 4.1: HUD should add a research component to the Moving to Work Demonstration included in the proposed Section 8 Voucher Reform Act (short-term). By adding a major research component to Moving to Work, with the funds needed to execute it, HUD could rigorously evaluate a series of alternative strategies for helping families in public housing and the voucher program make progress toward self-sufficiency. The emphasis should be on comparatively low-cost solutions that could be taken to scale.

Recommendation 4.2: HUD should conduct a demonstration to examine how to take Shared Equity Homeownership to scale (short-term). Shared equity homeownership is a promising approach for providing lower income families with sustainable homeownership opportunities, but most current programs are relatively small. A research demonstration could study different approaches for taking shared equity homeownership to scale, while also helping to meet pressing short-term needs for foreclosure prevention, neighborhood stabilization, the creation of jobs through new construction / substantial rehab, and the creation and preservation of affordable housing near public transit. The demonstration could be incorporated into the Neighborhood Stabilization Program or executed as a stand-alone program. In either case, the demonstration would help to raise the profile of this promising practice, assess how programs could operate efficiently at scale, and encourage states and localities to consider this model in planning their expenditures of HOME, CDBG and locally generated funds.

Recommendation 5: HUD should use performance measurement as a tool for ensuring local accountability (medium-term).

HUD should develop measures of performance that will allow individuals at the state and local levels to hold their housing departments and agencies accountable and conduct trainings to empower state and local legislative officials, as well as community members, on how to use and interpret these findings. The HOME program in the Office of Community Planning and Development has already created such a report (which they call a “dashboard” report).⁹⁵ These efforts should be supported and expanded to other offices within HUD, including Public and Indian Housing.

Recommendation 6: HUD should expand its support for building the capacity of non-profit and civic organizations (medium-term).

Local organizations, if trained and supported, have the capacity to help fulfill HUD’s programmatic goals efficiently and to allow for context-specific innovations. HUD has a long history of funding capacity-building efforts through LISC, Enterprise, Living Cities, and others. HUD should examine these efforts closely to determine how they could be expanded and linked to other similar efforts by other national nonprofit associations, philanthropic funders and state governments. Among the possible directions of capacity building are:

- Allocating funds to community-based organizations engaged in effective community self-help/organizing; tenant groups in public and Section 8 housing that work to improve neighborhood conditions; congregation-based organizing groups; and youth-development organizations that promote community service. Most of these funds should go to regional and national intermediaries that provide training, technical assistance and networking (e.g., Center for Community Change and Gamaliel).
- Training state and local legislators, citizen groups, and organizations to monitor what HUD and local and state housing agencies are doing and how their funds are being used, using digital information and other methods.
- Setting up alternative approaches to building local capacity which more effectively reward organizations that achieve high levels of performance. If local and state governments systematically rewarded high-performing

⁹⁵ <http://www.hud.gov/offices/cpd/affordablehousing/reports/dash.cfm>

entities with CDBG and other funds, these organizations could expand and become even more effective and sustainable. While there are a number of challenges to implementing this idea – including how to identify high performers and how to ensure that new organizations have the opportunity to demonstrate performance – it is worth considering how HUD could provide support for such an effort.

Recommendation 7: HUD could build on the outreach capabilities developed by the Obama Campaign to engage citizens directly in change (medium-term).

Work with national nonprofits such as YMCA-USA, United Way, Local Initiatives Support Corporation (LISC), Enterprise, Rebuilding Together, and Habitat for Humanity, as well as major national foundations, to launch a Community Change Corps that mobilizes local volunteers for specific, time-limited campaigns. The Obama presidential campaign inspired a remarkable degree of citizen involvement and an Obama presidency has the potential to do the same—transforming citizens’ relationships to each other and their community. HUD should be a leader in building national coalitions and campaigns to energize citizen engagement in influencing local decisions and changing local conditions in direct, hands-on ways. Several conditions stimulate citizen involvement: a measurable, achievable, and inspiring goal; stable teams of volunteers organized and supported to achieve short-term targets that require general, not specialized, skills; and highly decentralized “locally owned” control of teams and activities to allow speed and creativity and build commitment. We have considered several targets for the Community Change Corps:

- Energy use/cost reduction: volunteers conduct residential energy audits to advise homeowners and renters about easy ways to cut energy use and rehabilitate housing to boost energy efficiency, as well implementing energy-efficient improvements.
- Student success: volunteers provide tutoring, mentoring, and workplace internships for middle- and high-school students.
- Toddler health: volunteers ensure that every child under 2 in a neighborhood is tested for lead poisoning.
- Community safety: volunteers work with local law enforcement to bolster community policing and crime watches during high-crime periods.

Recommendation 8: Develop a strategic investment plan for data gathering and information products and services (short- and medium-terms).

Current, accurate, detailed socioeconomic data provided mainly by HUD are critical for informing intelligent housing and urban development policy and programs at all levels of government as well as for promoting efficient market behaviors. Local stakeholders, such as local governments, often have different uses for the data than national advocates, the Congress, and businesses. Unfortunately, due to years of neglect, the nation’s housing statistics fall substantially short of meeting user needs, particularly in light of the current crisis in housing finance. As a result, HUD has little systematic data capacity. Data availability is uneven and data accessibility has fallen behind the information technology curve. The department has information burrowed within its programs but it has limited capacity to use it, let alone make it available in a systematic way to users. HUD stakeholders need user-friendly data and analytics to help them make decisions, including decisions related to HUD programs. These information resources do not currently exist.

Creation of a high-performing data system has to occur in an incremental way. Rather than seeking a “grand redesign” of all HUD data systems, it makes more sense to start by working with stakeholders to identify their priorities for information. Let demand drive change. Some of the needs of local stakeholders are already evident. Specifically:

- HUD should ensure access to current, accurate, detailed socioeconomic data for local areas, particularly with regard to population size and characteristics, economic conditions, and housing supply, characteristics, and market conditions. Of particular importance are adequate funding and implementation for the decennial census, the American Community Survey, other Census Bureau housing-related programs, and local economic statistics programs housed at the U.S. Census Bureau, Bureau of Labor Statistics, and Bureau of Economic Analysis; a redesigned population estimates program; a revitalized American Housing Survey; the creation of new efforts to assess current local housing and residential finance market conditions; and an overall assessment of the extent to which local officials, advocates and practitioners have the data they need.
- HUD’s Office of Policy Development and Research (PD&R) should work with private, public, and nonprofit data integrators such as Dataplace, Policy Map, and Economy.com, as well as other federal agencies such as

the Department of Transportation, to develop an integrated Web-based capacity that provides data products and tools (e.g., maps and tables) with integrated and geospatial HUD and non-HUD data.

- HUD’s Office of Community Planning and Development should develop a strategy to help create and use an array of local information and indicator systems and analytic tools for community development that have emerged in the last decade.
- HUD should produce an annual State of Metropolitan Areas Report, a successor to the defunct State of the Cities Report. (This could be done in collaboration with other federal departments.)

Recommendation 9: HUD should consider establishing a “service charter” to empower residents of public and assisted housing to play a larger role in the governance of their communities (medium-term).

Millions of low-income individuals and families depend on HUD Housing Choice Vouchers, administered by HUD or Public Housing Authorities (PHA), to pay for their housing or live in PHA rental units that are partly subsidized by HUD. But they have limited power to respond to failures by the bureaucracy, local entities, or landlords. HUD should consider how to empower this constituency’s ability to influence its living conditions while also ensuring that high-performing landlords have responsible tenants and, therefore, are willing to house section 8 tenants.

One option would be to establish a “service charter” that sets standards of service for these individuals and families. If HUD or the local entity or landlord fails to meet standards, it would face consequences. A service charter sets standards of service that define levels and quality of services; determines guarantees that promise some redress – compensation, for instance – if the standard is not met or the customer is not satisfied; establishes a complaint system that tracks and analyzes complaints and ensures prompt responses; and creates a customer council that holds HUD accountable for meeting standards. As part of the implementation of this idea, HUD could:

- Use focus groups, panels, and surveys to find out what its constituencies consider to be acceptable standards for HUD or PHA service and to involve frontline employees in setting specific, measurable standards.
- Further educate its constituencies about its services and standards and about their role as responsible tenants – so they know what to expect and demand.
- Establish Constituency Service Councils to which it regularly reports its service performance – and which advise HUD on possible improvements to make in service.
- Regularly publicize its standards, guarantees, redress policies, complaint systems, and results.
- Provide employees who serve these constituencies with financial and other incentives for meeting the standards.

Another potential approach would be to establish a framework in which tenants in both Section 8 and public housing have rights to form and join a “tenants union” that could bargain collectively with housing authorities and landlords in subsidized developments over code conditions, safety, evictions and have a voice in creating and implementing job training, literacy, parenting, and other social programs.

C. Structural Redesign

Recommendation 10: Establish new offices within HUD to focus attention on core priorities of the Administration and HUD (short-term).

For example, HUD should establish and staff an Office of Energy Policy to more effectively coordinate the activities of the various HUD offices related to improving the energy-efficiency of HUD-assisted housing and increasing the availability of housing affordable to families with a mix of incomes near public transit and job centers. This Office should also be charged with working to identify ways to improve the energy- and location-efficiency of private-sector housing as well. All of these objectives have both policy development and research dimensions, making the Office for Policy Development and Research a logical place to host the office.

Recommendation 11: Elevate the importance of inter-agency partnerships to achieve key Administration and HUD priorities (short-term).

HUD has a long history of participating in inter-agency partnerships, but these partnerships often fail to produce lasting change. If HUD is to exert influence on housing issues that extend beyond the boundaries of the programs it funds, these inter-agency partnerships need to be elevated to the Secretary level and held accountable for results.

- For example, to advance the goals of energy efficiency and energy security, HUD should strengthen and expand its existing partnerships with the Departments of Energy and Transportation related to the intersections of housing, transportation, and energy policy.
- Similarly, HUD should strengthen and expand its partnerships with the Federal Housing Finance Agency, the Treasury Department, and the Federal Deposit Insurance Corporation, and take a leadership role in coordinating the government's response to the foreclosure crisis, including providing more effective mortgage workout counseling.

Recommendation 12: Initiate a 90-day internal reinvention process to identify options for redesigning the purpose, structure, and operations of HUD's regional field offices (short-term).

The role of field offices has changed substantially over the years, and the current structure appears to reflect an amalgam of different and potentially conflicting roles. Many practitioners hearken back to a time when field office directors had much greater authority to respond to local needs, helping HUD play a more proactive role in local communities. While much of this authority has been lost over the years – apparently due to the understandable desire of HUD HQ office to control the implementation of their programs at the local level – the prior Administration took some partial steps to restore this autonomy, particularly for the new level of Regional Directors. A number of knowledgeable observers recommend that HUD take further steps in the direction of enhancing the role and authority of field and regional directors.

While an in-depth examination of the history and role of HUD field offices is beyond the scope of this report, it is clear that HUD needs to develop a clearer vision for how the field offices will enable better outcomes at the local level and how they interact with the rest of the Department. We recommend that an internal group be established to examine previous models for field offices and efforts such as Community Builders for transforming the interface between local-level players and HUD programs. The group's report on options should be widely circulated outside HUD for comments. The group should package the options and comments into a report to the HUD Secretary. If feasible, it may make sense to delay filling field and regional office directors until the Secretary has decided exactly what role he would like them to play.

Recommendation 13: To fund the research demonstrations, promising practices identification, program evaluations and other research needed to catalyze change, HUD should develop a reliable funding base for research by setting aside a small portion of the budget of every program (short-term).

In its 2008 report, *Rebuilding the Research Capacity at HUD*, the National Academy of Sciences argued that HUD needed to expand its funding and capacity to perform high-quality and impactful research. To implement this recommendation, HUD should include a provision in the FY 2010 budget and all subsequent budgets setting aside for research no less than 0.5 percent and no more than 2.0 percent of the amounts appropriated for each HUD program. This is necessary to ensure that a consistent stream of funding is available to evaluate new ideas for improving both HUD programs and state and local housing and community and economic development strategies.

Recommendation 14: HUD should support and participate in a portfolio of "learning networks" of innovators, local officials, experts, and philanthropic funders focused on critical issues in affordable housing and community development (medium-term).

The focus of an initial set of learning networks could be:

- Community implementation of a federally supported building energy retrofit initiative.
- Development of urban-suburban and regional partnerships for affordable housing.
- Reinvention of community development corporations.
- Development of a model set of local government standards for participation of low-income individuals and neighborhoods in government decision-making processes.
- Development of regional provider networks for homeless people.

D. Systems Development

Recommendation 15: Engage HUD staff and partners in the process of developing structural changes to improve the way HUD does business (short-term).

HUD is widely perceived as an obstacle, rather than a contributor, to progress at the local level. Many practitioners believe HUD's rigid rules, slow response times, and fragmentation make it much harder and more expensive to build affordable housing and complete projects that anchor community development efforts. A series of structural changes is needed to fix this problem, but, ultimately, the most critical fix is a change in culture catalyzed by strong leadership (top-down), effective engagement with outside constituencies (outside-in), empowerment of staff (bottom-up) to identify needed improvements, and improved communication across HUD offices and between HUD and other agencies (cross-cutting).

To signal the desired change in HUD culture, the Secretary needs to send a powerful message to staff and to stakeholders that HUD will be a strong partner that seeks to "enable" positive outcomes at the local level. A speech or letter is not enough. Instead, we recommend the following:

Recommendation 15.1: As early as practicable, HUD should launch an intensive time-limited agency-wide process to collect ideas from staff and stakeholders on specific process improvements that HUD could take to streamline approvals, improve utilization of existing programs, and otherwise improve the way it does business. Input should be collected through meetings in Washington and at each Field Office, as well as electronically. HUD should commit publicly to adopting as many suggestions as possible within 60 days and publishing a complete inventory of input received, as well as a response on whether each item will be adopted and, if not, why not.

As part of this process, we recommend the Secretary call a meeting with all career SES-level officials to lay out his vision for HUD and request their input and support. The Secretary will need their support and they will appreciate his personally reaching out. As you may recall, Secretary Cisneros did this to beneficial effect.

Within one year, HUD should propose new regulations and legislation to address worthy changes that surface during the improvement-suggestion process but need authorization.

Recommendation 15.2: To strengthen the effectiveness of HUD's grant-making systems, we further recommend the following:

- *Obtain expert input on how to streamline HUD's major grant-making systems and other programmatic activities (short-term).* Even as HUD engages stakeholders and staff in a short-term, intensive process to identify changes that could make HUD a better partner at the state and local level, it would be useful to bring in experts who can take a more holistic approach to developing recommendations for streamlining HUD's grant-making and other programmatic activities, such as the issuance FHA insurance. Complex, important systems should always be subject to processes for continuous, incremental improvement and periodic reengineering to apply advances in technology and new thinking to the inefficiencies that build up in the systems. HUD should create teams that combine outside experts and inside managers to examine current performance of the systems and to design processes for significantly improving performance.
- *Create more predictability in HUD's grant programs (short-term).* For partners to respond to the incentives that HUD establishes, those incentives need to be relatively stable. Unfortunately, HUD often chooses to use the annual Notice of Funding Availability (NOFA) process to announce changes in incentives – and even sometimes rates agencies on how they performed under these new incentives for the period *prior* to their establishment. While this may seem like a good idea to HUD staff who lack other mechanisms for influencing local behavior, the result is often confusing and counterproductive, as local partners scramble to meet the constantly shifting demands. Ideally, HUD should stop making policy through NOFAs, and instead should use the normal regulatory and guidance process. Whatever the mechanism, HUD needs to announce its priorities and then stick to them long enough for agencies to understand and implement them. While changes are needed, they should be much less frequent, made in consultation with outside stakeholders, and advertised well before they are put into place.

Recommendation 16: Use performance measurement more effectively as a management tool (short-term). HUD devotes a considerable amount of time to complying with the requirements of the Government Performance and Results Act, but does not use the performance data it generates as a real management tool. In addition, the

overwhelming number of indicators makes it hard for outsiders to follow. We recommend the following:

Recommendation 16.1: HUD should create a “dashboard” of a small number of key measures of department performance, rather than the scores of silo-based indicators listed in the department’s annual performance report. HUD management should be held accountable—through performance management incentives and sanctions—for achieving these dashboard goals.

Recommendation 16.2 HUD should report regularly and publicly on its performance under the dashboard goals and document the corrections it is making mid-stream to achieve its goals.

Recommendation 17: Work with stakeholders and practitioners to identify key HUD program performance data that would help them do their jobs better and work to release those data regularly (short- and medium-terms).

Examples would include data on the number and location of households being served by HUD (the most recent Picture of Subsidized Housing that supplies this information uses 2000 data) and data on the results of physical inspections of public and assisted housing and the results of customer surveys in the housing voucher program. These data should be released in a form that readily enables local officials and others to understand how the performance of agencies in their community compares with the performance of agencies elsewhere.

As part of this process, HUD should actively mine the administrative records it develops through its programs for useful information on trends and patterns by type of grantee, type of community assisted, etc., and release the results in a format that helps HUD partners and stakeholders understand the impacts of HUD programs and what adjustments might be needed to achieve desired outcomes.

Recommendation 18: Provide stronger support for local data collection efforts (medium-term).

To make informed decisions, local governments need to consider both large datasets generated by federal investments – for example, data from the American Community Survey, Decennial Census, and American Housing Survey – as well as locally-generated data, such as data on foreclosures, vacant properties, etc. A number of communities have invested in local data collection and analysis efforts – including 31 cities involved in the Urban Institute’s National Neighborhood Indicators Project. These efforts are paying huge dividends by helping communities target their efforts to stabilize communities impacted by foreclosures. These local data-capacity efforts warrant more support from HUD to ensure they are coordinated, sustained, and expanded to other areas.

Recommendation 19: Engage stakeholders more closely in developing policy (short- and medium-term).

HUD’s partners have developed a considerable body of experience in how to use HUD’s programs as part of larger housing and community development strategies. In addition to seeking their input on “process fixes” to make the existing programs work better, HUD should get into the habit of consulting more closely with the full range of stakeholders for input on future policymaking. Specifically:

- HUD should identify specific areas where it would like assistance from stakeholders – for example, to improve the energy-efficiency of HUD-assisted housing or to improve the financing for small multifamily housing developments – and develop a process for systematically reaching out to knowledgeable practitioners and inviting them to work collaboratively with HUD staff to develop appropriate recommendations.
- On each topic that HUD selects for input from knowledgeable practitioners, HUD should also seek input from a broader range of stakeholders through electronic communications and/or through a request for comments in the Federal Register. Wherever possible, HUD should make a practice of seeking this input *before* publishing a proposed regulation, at which time it becomes much harder under applicable law to engage in a substantive conversation about the comments.

Recommendation 20: Address critical staffing needs (short- and medium-terms).

HUD suffers from a general staffing shortage that in some cases will impede progress on critical short-term matters. The following are initial recommendations:

- Whatever staffing issues affect the rest of the department, it is essential that they not impede the work of the Secretary. Since the Secretary's office is very small, the Secretary should use the Office of Policy Development and Research as an extension of the Secretary's own capacity. To this end, HUD's chief policy advisor should be located in the Office of Policy Development and Research – either as an Assistant Secretary or Deputy Assistant Secretary for Policy. This will enable the Secretary to tap into experienced staff in the policy development division as well as to shape and use the base of data and research needed to implement the newly devised agenda.⁹⁶
- There is an urgent need to expand staffing and capacity in FHA. FHA's loan volume has shot through the roof, but they are working with a skeletal staff compared with earlier decades when FHA was operating at comparable volume. HUD also needs to develop process and technology changes that can enable it to safely operate FHA at its current scale with a greatly truncated staff.
- HUD should inventory and fill key staff vacancies and develop a more strategic approach to allocating and hiring staff. Having a strong, visible leader like the Secretary-Designate will help with recruitment.
- HUD should continue to place emphasis on urban internship programs that bring in good people at the beginning of their careers to tap their energy and introduce them to a career in housing.

Recommendation 21: HUD should develop an intern/extern program to facilitate the exchange of ideas between HUD staff and outside practitioners (medium-term).

HUD staff should be encouraged to pursue externships where they work in the offices of state and local practitioners, and practitioners should be invited to intern at HUD to learn more about how HUD works and to share their experience. HUD has had such programs at various times, and may currently have one, but they warrant greater emphasis.

SOME LEADERSHIP REQUIREMENTS FOR TRANSFORMING HUD

Implementing these or other similarly transformational recommendations during 2009 at HUD will require the agency to take big steps forward. The effort will require sustained personal leadership from the Secretary. This cannot be delegated. The Secretary will have to display passion for the change and faith that change can be achieved, and he will have to craft and deliver the message of change within HUD and to stakeholders and persuade the Congress to support the effort. Just as important, the Secretary will have to model the behaviors of catalytic government—openness, enabling of others, and a laser-focus on results.

(A true results focus will mean that the Secretary should make a public commitment to assessments of HUD's performance and decision-making processes strongly based in evidence—and this sort of potential accountability will make many people inside and outside HUD nervous.)

The Secretary will have to assemble a team of change champions from inside HUD, outside stakeholders, and experts (advisors and consultants) in the process of public sector organizational change to drive the multiple necessary change processes. In short order, the team will have to develop a detailed plan of action, probably covering the second and third years of the Administration, and a plan for mobilizing stakeholders not just to support changes, but to become an active part of making change happen.

The Secretary and his leadership team will have to create an organizational culture in which risk-taking is valued and rewarded; they will have to do this by example. The Secretary must seek input from HUD employees and recognize and reward those who step forward.

In our view, this is what it will take to put HUD “back on the map” in a way that is transformative and sustainable for HUD and those it serves.

⁹⁶ Jack Kemp used this structure to great success and Henry Cisneros also relied heavily upon the Office. Secretary Martinez gave up direct control of PD&R by relocating the chief advisor to the Secretary's Office.

APPENDICES



RETOOLING HUD

for a CATALYTIC FEDERAL GOVERNMENT:
a REPORT to SECRETARY SHAUN DONOVAN

Penn Institute for Urban Research
University of Pennsylvania

APPENDIX 1

PROJECT DIRECTORS AND TASK FORCE MEMBERS

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

PROJECT DIRECTORS

Paul Brophy	Principal, Brophy & Reilly LLC
Rachel Godsil	Eleanor Bontecou Professor of Law, Seton Hall University School of Law

TASK FORCE MEMBERS

PART 1: Providing and Preserving Housing and Housing Markets

Chapter 1: Preventing Foreclosures

Bart Harvey, Co-Chair	Former Chair and CEO, Enterprise Community Partners
Barry Zigas, Co-Chair	Director, Housing Policy for Consumer Federation of America
William Apgar	Senior Scholar, Joint Center for Housing Studies, Harvard University
Charles Laven	President, Forsyth Street Advisors LLC
Mary K. Reilly	Principal, Brophy & Reilly LLC
Eric Stein	President, Center for Community Self Help
Sarah Wartell	Executive Vice President, Center for American Progress
Stockton Williams	Senior Vice President, Enterprise Community Partners
Mark Willis	Visiting Fellow, The Ford Foundation

Chapter 2: Improving the Private Multi-Family Housing Programs

Charlie Werhane, Chair	President, Enterprise Community Investment
Gary Alex	Director of FHA Lending, Enterprise Community Investment
Margaret Allen	CEO, President and Chief Underwriter, AGM Financial
Anne Marie Brady	Policy Associate, Stewards of Affordable Housing for the Future
Michael Bodaken	President, National Housing Trust
Pat Clancy	President and CEO, The Community Builders, Inc.
Sheila Crowley	President, National Low Income Housing Coalition
Joe Hagan	President and CEO, National Equity Fund
Scott Hoekman	Senior Vice President and Chief Credit Officer, Enterprise Community Investment
Bill Kelly	President, Stewards of Affordable Housing for the Future
Scott Kline	Vice President, National Housing Trust
Aron Weisner	Enterprise Community Investment
Stockton Williams	Senior Vice President and Chief Strategy Officer, Enterprise Community Partners

Chapter 3: The “Hard to House”: Creating Housing Opportunities for those in Greatest Need

Rosanne Haggerty, Chair	President, Common Ground
Priscilla Almodovar	President and CEO, New York State Housing Finance Agency
Robert Barbor	Housing Manager Disaster Recovery Unit, Louisiana Office of Community Development
Patrick Costigan	Senior Vice President, The Community Builders, Inc.
Deborah DeSantis	President and CEO, Corporation for Supportive Housing
Fred Harris	Senior Vice President, AvalonBay Communities, Inc.
Cindy Holler	President, Mercy Housing Lakefront

Fred Karnas	Director, Arizona Department of Housing
Jesus "Jesse" Leon	Vice President, Banc of America Community Development Corporation
John McIlwain	Senior Resident Fellow, J. Ronald Terwilliger Chair for Housing, Urban Land Institute
Stephen Norman	Executive Director, King County Housing Authority
Nan Roman	President and CEO, National Alliance to End Homelessness
Tony Salazar	President, McCormack Baron Salazar
Eleanor White	President, Housing Partners, Inc.

PART 2: Reinvigorating Places – Neighborhoods, Cities, Suburbs, and Metropolitan Areas

Chapter 4: Improving Communities Impacted by Foreclosures

Dan Kildee, Chair	County Treasurer, Genesee County, Michigan
Frank Alexander	Professor Law, Emory University
Rick Ballard	Director of Community Development, Michigan State Housing Development Authority
Frank Ford	Vice President of Research and Development, Neighborhood Progress, Inc.
Bill Goldsmith	Regional president of Mercy Portfolio Services, Mercy Housing, Chicago
Ira Goldstein	Director of Policy and Information, The Reinvestment Fund
Amy Hovey	President, The Protogenia Group
Alan Mallach	Non-Resident Fellow, The Brookings Institution
Mercedes Marquez	Director, Los Angeles Housing Department
Craig Nickerson	President, National Community Stabilization Trust

Chapter 5: Strengthening America's Neighborhoods

Wendell Pritchett, Chair	Professor of Law, University of Pennsylvania Law School
Diane Bell-McKoy	President and CEO, Associated Black Charities
Carol Clark	Asst. Commissioner, NYC Dept. of Housing Preservation and Development
Beverly Coleman	Executive Director, Neighborhoods Now
Radhika Fox	Senior Associate, PolicyLink
George Galster	Clarence B. Hilberry Professor of Urban Affairs, Wayne State University
Brad Lander	Director, Pratt Center for Community Development
Alan Mallach	Nonresident Senior Fellow, The Brookings Institution
Mark Sissman	President, Healthy Neighborhoods, Inc.

Chapter 6: New Strategies for a Metropolitan America: Extending HUD's Urban and Regional Mission

Hal Wolman, Chair	Director, George Washington Institute of Public Policy, GWU
Patricia Atkins	Research Professor, George Washington Institute of Public Policy, GWU
Bill Barnes	Director, Center for Municipal Programs and Resources, National League of Cities
Bruce Fisher	Director, Buffalo State College Center for Economic and Policy Studies
Kathryn Foster	Director, University at Buffalo Regional Institute, SUNY
Dave Garrison	Non-Resident Senior Fellow, The Brookings Institution
Royce Hanson	Chairman, Montgomery County (MD) Planning Board
Bill Johnson	Distinguished Professor of Public Policy and Urban Studies, Rochester Institute of Technology
Bruce McDowell	Senior Fellow, National Academy of Public Administration
Jeremy Nowak	President, The Reinvestment Fund
Myron Orfield	Associate Professor of Law, Director of the Institute of Race and Poverty, University of Minnesota
Manuel Pastor	Professor of Geography; Director, Program for Environmental and Regional Equity, University of Southern California
David Robertson	Executive Director, Metropolitan Washington Council of Governments
Andrea Sarzynski	Research Professor, George Washington Institute of Public Policy, GWU
Todd Swanstrom	Professor of Political Science, University of Missouri - St. Louis.
Dale Thomson	Director, Institute of Local Government, U. of Michigan-Dearborn

Chapter 7: A City-Focused Economic Development Agenda for the Federal Government and HUD

Edward (Ned) Hill, Co-Chair	Interim Dean, Levin College of Urban Affairs, Cleveland State University
Fran Stewart, Co-Chair	Fellow, The Urban Center, Cleveland State University
William Barnes	Director, Municipal Programs and Resources, National League of Cities
Susan Clarke	Professor of Political Science, University of Colorado, Boulder
Joseph Cortright	Vice President/Economist, Impresa Consulting
Denise DiPasquale	President, City Research
Jeff Finkle	President, International Economic Development Council
David Garrison	Nonresident Senior Fellow, Brookings Institution
Marvin Hayes	Director, Governor's Office of Urban Development and Infrastructure, Ohio
Larry Ledebur	Director, The Urban Center, Cleveland State University
Amy Liu	Deputy Director, Metropolitan Policy Program, The Brookings Institution
Richard McGahey	Director of Impact Assessment, The Ford Foundation
Jeremy Nowak, President	The Reinvestment Fund
Phillip A. Singerman	Senior Vice President, B&D Consulting.

Chapter 8: Anchor Institutions as Partners in Building Successful Communities and Local Economies

Ira Harkavy, Chair	Associate Vice President and Director, Netter Center for Community Partnerships, University of Pennsylvania
Eugenie Birch, Co-Chair	Professor, School of Design, University of Pennsylvania
Gar Alperovitz	Prof., Dept. of Government and Politics, University of Maryland
Nancy Cantor	President, Syracuse University
Gerard Clancy, MD	President, University of Oklahoma-Tulsa and Dean, School of Community Medicine
Carol Coletta	President, CEOs for Cities
David Cox,	Executive Assistant to the President and Professor, University of Memphis
Salin Geevarghese	Senior Associate, The Annie E. Casey Foundation
Andrew Hahn	Professor, Brandeis University
James Harris	President, Widener University
Ted Howard	Executive Director, The Democracy Collaborative, University of Maryland
David Maurrasse	President and CEO, MARGA Incorporated
Eduardo Padrón	President, Miami Dade College
Carl Patton	President Emeritus, Georgia State University
David Perry	Associate Chancellor, University of Illinois at Chicago
Victor Rubin	Vice President for Research, PolicyLink
Beverly Tatum	President, Spelman College
Henry Taylor	Professor and Director, Center for Urban Studies, University at Buffalo
Henry Webber	Executive Vice Chancellor for Administration, Senior Lecturer, Washington University in St. Louis
Wim Wiewel	President, Portland State University
Rita Axelroth, Staff	Research Associate, Netter Center for Community Partnerships, University of Pennsylvania
Steve Dubb, Staff	Senior Research Associate, The Democracy Collaborative, University of Maryland
Eleanor Sharpe, Staff	Associate Director, Netter Center for Community Partnerships, University of Pennsylvania
Joann Weeks, Staff	Associate Director, Netter Center for Community Partnerships, University of Pennsylvania

PART 3: Building HUD's Capacity and Developing New Initiatives

Chapter 9: Facilitating Green Housing

John Cleveland, Co-Chair	Vice President, Innovation Network for Communities
Anne Evens, Co-Chair	Director of Energy Division, Center for Neighborhood Technology
Bracken Hendricks	Senior Fellow, Center for American Progress
Stockton Williams	Senior Vice President and Chief Strategy Officer, Enterprise Community Partners

Jonathan Rose	President, Jonathan Rose Companies
Ben Hecht	President and CEO, Living Cities
Joel Rogers	Director, Center on Wisconsin Strategy

Chapter 10: Catalyzing Change at HUD: Building a More Effective Department

Jeff Lubell, Co-Chair	Executive Director, Center for Housing Policy
Peter Plastrik, Co-Chair	President, Innovation Network for Communities
Peter Dreier	Professor of Politics and Director of the Urban and Environmental Policy Program, Occidental College
Rachel Godsil	Eleanor Bontecou Professor of Law, Seton Hall University School of Law
Andrew Reamer	Fellow, Metropolitan Policy Program, The Brookings Institution

APPENDIX 2

ACRONYM DEFINITIONS

Retooling HUD
for a Catalytic Federal Government:
A Report to Secretary Shaun Donovan

Penn Institute for Urban Research
University of Pennsylvania

AARP	American Association of Retired Persons
AHAR	Annual Homeless Assessment Report
AMI	area median income
AMT	alternative minimum tax
ARM	adjustable-rate mortgage
BEDI	Brownfields Economic Development Initiative
BEEF	Building Energy Efficiency Finance
BPI	Business and Professional People for the Public Interest
CDS	credit default swap
CDBG	Community Development Block Grant (CPD Program)
CDC	community development corporation
CDFIs	community development financial institutions
CDO	collateralized debt obligation
CHAP	Community Health Anchor Partnerships
CMS	Centers for Medicare and Medicaid Services
CNCS	Corporation for National and Community Services
CoC	Continuum of Care approach to assistance to the homeless
COGs	council of governments
COPC	Community Outreach Partnership Centers Program (PD&R Program)
CPD	(HUD Office of) Community Planning and Development
CRA	Community Reinvestment Act
DOC	(U.S.) Department of Commerce
DOE	(U.S.) Department of Education
DOL	(U.S.) Department of Labor
DOT	(U.S.) Department of Transportation
DSR	debt service ratio
EDA	(U.S. Department of Commerce) Economic Development Administration
EECBG	Energy Efficient and Conservation Block Grants
EEM	energy-efficient mortgage
EESA	Emergency Economic Stabilization Act
Energy	(U.S.) Department of Energy
EPA	(U.S.) Environmental Protection Agency

ESCO	Energy Service Company
EZ	Empowerment Zone
FASB	Financial Accounting Standards Board
FAS 140	Financial Accounting Standards No. 140: Accounting for Transfers and Servicing of Financial assets and Extinguishments of Liabilities (a standard by FASB)
FDIC	Federal Deposit Insurance Corporation
FEMA	Federal Emergency Management Agency
FHA	(HUD Office of) Federal Housing Administration
FHFA	Federal Housing Finance Agency
FTA	(U.S. Department of Transportation) Federal Transit Administration
GAO	(U.S.) General Accountability Office
GIS	geographic information systems
GHG	greenhouse gas
GNMA	Government National Mortgage Association (known as Ginnie Mae)
GO Zone	Gulf Opportunity Zone
GSE	government-sponsored enterprise (such as Fannie Mae and Freddie Mac)
HAP Contract	Housing Assistance Payment Contract
HERA	Housing and Economic Recovery Act of 2008
HFA	Housing Finance Agency
HHFA	Housing and Home Finance Agency
HHS	(U.S. Department of) Health and Human Services
HOME	Home Investment Partnerships (CPD program)
HOPA	Housing for Older Persons Act
HOPE IV	Program for Revitalization of Severely Distressed Public Housing (PIH program)
HUD	(U.S. Department of) Housing and Urban Development
I-CAN	Integrated Community Anchor Network
IECC	International Energy Conservation Code
IPA	Interagency Personnel Agreement
IRS	(U.S. Department of Treasury) Internal Revenue Service
LEM	location-efficient mortgage
LIHTC	Low Income Housing Tax Credit
LISC	Local Initiatives Support Corporation
LTV	loan to value ratio
MAP Guide	Multifamily Accelerated Processing Guide
MBAA	Mortgage Bankers Association of America
MBS	mortgage-backed securities
MERS	Mortgage Electronic Registration System
MIP	mortgage insurance premium
MPO	Metropolitan Planning Organization?
MRB 10-yr rule	Mortgage Revenue Bond Ten-Year Rule

MTM	Mark to Market
NCST	National Community Stabilization Trust
NEA	National Endowment for the Arts
NEH	National Endowment for the Humanities
NHMS	National Home Management Solutions
NHTF	National Housing Trust Fund
NiB	Neighborhood in Bloom
NIMS	National Incident Management System
NOFA	(HUD) Notice of Funds Available
NPV	net present value
NRC	National Research Council
NSP	Neighborhood Stabilization Program
OCC	Office of the Comptroller of the Currency
OGC	(HUD) Office of General Counsel
OMB	(U.S.) Office of Management and Budget
OUP	(HUD) Office of University Partnerships
PATH	Partnership for Advanced Technology in Housing (PD&R Program)
PD&R	(HUD Office of) Policy Development & Research
PHA	Public Housing Authority
PHR	Public Housing Retrofit
PIH	(HUD Office of) Public and Indian Housing
PILOT	payment in lieu of taxes
PLS	private label securities
PM	partnership mortgage
PSAs	pooling and servicing agreements
RAP	Rental Assistance Payment
REAC	(HUD) Real Estate Assessment Center
REMIC	Real Estate Mortgage Investment Conduit (under Ginnie Mae)
REO	real estate owned (in reference to defaulted FHA-insured properties)
RMBS	residential mortgage-backed securities
SBA	(U.S.) Small Business Administration
SDQs	serious delinquencies
SEC	(U.S.) Securities and Exchange Commission
SIVs	secured investment vehicles
TARP	Troubled Assets Relief Program
TDC	total development cost
TIP	Transportation Investment Plan or Transportation Improvement Program
TOD	transit-oriented development
TPA	Transfer of Physical Assets
UDAG	Urban Development Block Grant

UPB	unpaid principal balance
USDA	U.S. Department of Agriculture
VA	Department of Veterans Affairs (U.S. Department of)
VASH	Veterans Affairs Supportive Housing
VISTA	(AmeriCorps) Volunteers in Service to America
VMT	vehicle miles traveled
VRD	variable rate demand
WHOUMP	White House Office of Urban and Metropolitan Affairs
YMCA-USA	Young Men's Christian Association United States of America

APPENDIX 3

ABOUT THE SPONSORS

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Penn Institute for Urban Research
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Penn Institute for Urban Research (Penn IUR) is a university-wide entity dedicated to an increased understanding of cities through cross-disciplinary research, instruction, and civic engagement. As the global human population becomes increasingly urban, understanding cities is vital to informed decision-making and public policy at the local, national, and international levels. Penn IUR is dedicated to developing knowledge in two critical areas: building the sustainable, 21st-century city and the role of anchor institutions in urban development. By providing a forum for collaborative scholarship and instruction across Penn's twelve schools, Penn IUR stimulates research and engages with the world of urban practitioners and policymakers. www.upenn.edu/penniur

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