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PUBLIC HOUSING: FROM TENANTS TO HOMEOWNERS

INTRODUCTION

Public housing projects in the United States have come to epitomize urban blight. While this view is exaggerated, it is nevertheless true that public housing represents one of the great ironies of federal intervention. When the program began in the 1930s, the assumption was that the projects would help ameliorate social problems in the cities by stabilizing communities and the housing stock. The reverse has been true.

Yet there is evidence, in this country and abroad, that certain inner city housing experiments can have positive results. They all have one thing in common--ownership. Whether the program is homesteading, where abandoned properties can be bought for a dollar, or the discounted sale of public housing to tenants (in Britain), the effect is the same. When residents acquire an equity stake in the future of their building, and hence their neighborhood, they gain incentives to change their behavior from destructive to constructive and to urge their neighbors to do likewise. And instead of economic improvement bringing with it the threat of increased land values and displacement, equity allows a resident to rise with the tide--not drown in it.

But, some would argue, the low income of public housing tenants precludes their becoming homeowners. The solution to this apparent barrier is to recognize that support for homeownership is entrenched in the tax codes. Thanks to the mortgage interest deduction, middle- and upper-income Americans have powerful tax incentives to become homeowners. This is no accident. The explicit purpose of the deduction is to help Americans purchase homes. Yet the low-income tenant, who pays little or no income tax, has no such incentive--so he must pay a far higher after-tax price than higher-income citizens buying exactly the same property.

Congress and the Administration should recognize this inequity and establish a "Right to Buy" homeownership program in the inner cities, based on the sale of public housing buildings, at a substantial discount, to associations of occupying tenants. The Reagan Administration should establish an experimental program immediately using existing law. It should also seek legislation to permit tenant associations to apply directly to the Secretary of Housing and Urban Development (HUD) for permission to purchase buildings from their local Public Housing Authority (PHA). The legislation should also allow the Secretary to require the PHA to provide the tenant group with a mortgage.

Proponents of such a program would be blind if they overlooked its political advantages. A similar plan in Britain enabled Conservative Margaret Thatcher to make considerable inroads among traditionally Labor-voting public housing tenants in her landslide 1983 reelection. The New York Times noted after the election that:

> As political experts and party strategists sift through the results of Labor's crushing defeat...more and more are identifying the "homeowner mentality" of voters...as a crucial development.[1]

An inner city homeownership plan would extend the idea of owning a home to low-income Americans. It would help stabilize the value of public rental stock near tenant-owned units, and would plant the seeds of improvement in the nation's most desolate neighborhoods. It would be a logical companion to the enterprise zone approach to inner city development. Like the zone proposal, which seeks to unlock the entrepreneurial spirit, the Right to Buy program would draw on the strengths of residents to tackle the problems of their own community.

THE BRITISH RIGHT TO BUY PROGRAM

During the last five years, over 500,000 dwellings (out of a total public housing stock of approximately 7 million units) have been sold to public housing tenants in Britain under the "Right to Buy" scheme. Widening homeownership in this way is seen by the Thatcher government as central to its objective of reviving neighborhoods and encouraging self-improvement.

Stated simply, Britain's Right to Buy program allows public housing tenants to purchase their units at a discount on the market value of up to 60 percent, based on the length of tenancy.

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1 "In Housing Policy, It Seems the Tories Had a Winner," The New York Times, June 22, 1983.

1) Eligibility

A tenant obtains the right to buy if he or she has been a public housing tenant for at least two years[2] and the unit is the principal home. The tenant can purchase the unit jointly with up to three other family members, provided they have been living in the same unit for at least three months.

2) Discount

If the tenant has lived in public housing for three years, the unit can be bought at the market value less 33 percent. The discount increases by 1 percent for each additional year as a tenant, up to a maximum 60 percent discount after 30 years as a tenant.[3] The period counting toward the discount need not have been spent in the same unit, or even within the jurisdiction of the same housing authority. The valuation, upon which the discounted price is based, is calculated by the housing authority. If the tenant disagrees with that valuation, he can appeal to the District Valuer, an independent official whose decision is legally binding on both parties.

3) Finance

The purchaser has three options in raising the money to pay for the house.

a) The tenant can obtain a mortgage from a savings and loan association. Approximately half of all public housing sales are financed in this way.

b) The tenant has the legal right to a mortgage from the local housing authority. Basically the loan amount is limited to 2½ times the annual income of the purchaser, plus 1 times the annual income of any other family members assisting in the purchase. For purchasers over 60 years of age, the multiple is lower.

c) The tenant may buy the unit in stages. After buying at least 50 percent of the unit, with the usual discount according to length of tenancy, he can obtain full ownership by purchasing increments of 12½ percent. The tenant continues to pay rent on the portion still owned by the housing authority.

Like the purchaser of privately built housing, the public housing tenant-buyer can deduct mortgage interest payments from taxable income. The trouble has been that, if the low-income purchaser pays little or no income tax, the mortgage deduction is

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2 Decreased from three years in legislation passed in 1983.

3 Prior to the 1983 legislation, the maximum discount was 50 percent after 20 years.

practically worthless. Since April 1983, however, a low-income buyer in Britain has been able to utilize the Mortgage Interest Relief at Source Program. Under this, he can obtain a cash subsidy equal to the tax relief to which he is entitled (at the 30 percent lowest bracket), less the amount he can actually deduct from his tax bill--in effect a refundable mortgage deduction.

4) Value Recapture

A tenant-buyer cannot buy his unit one day with a 60 percent discount, sell it the next at the full market rate, and walk away with the difference. If the unit is sold within one year of the initial purchase, 100 percent of the discount must be repaid. This repayment requirement falls by 20 percent each year until, after five years, the unit can be resold without the repayment of any portion of the discount.

ANALYSIS OF THE BRITISH EXPERIENCE

The British program of public housing sales has been highly popular and had profound effects on many neighborhoods. As the program's proponents expected, signs of home improvement activity, close attention to maintenance, and resident involvement in neighborhood issues have become evident in communities where tenants are buying. The reason for this is simple, says Conservative Councilwoman Hazel Weiberg, "ownership gives them a greater stake in the community."[4]

Distribution of Housing and Sales

Approximately one-third of all housing in Britain is publicly owned rental accommodation. This is above the average for Western Europe, and far above the 1.5 percent in the U.S. In addition, the mean income of families in British public housing is not far below that of owner-occupying families, and it is a shade higher than families in private rental units. One reason for this is that local housing authorities cannot evict tenants whose incomes rise above the initial threshold for their unit. Moreover, the right of tenancy in a public housing unit in Britain can be passed on to an heir who has lived with the tenant. British public housing structures also differ from those found in American cities. While there are many examples of blighted high-rise properties, more typical is the well-built duplex or four-unit walk-up in a reasonably stable neighborhood.

The sales of British public housing reflect these characteristics. Data for 1982, for instance, indicate that the average

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[4] "New Law Transforms Britain Into a Nation of Homeowners," Wall Street Journal, September 14, 1983.

income of tenant purchasers was only 16 percent lower than that of all first-time house buyers in Britain, and 96 percent of public units sold were town houses, duplexes, or detached houses (only 4 percent were apartments). Nevertheless, sales were more common among lower-income public housing tenants than is usual for first time buyers. Forty-seven percent of public housing purchasers earned less than $10,000 a year (34 percent for all first-time buyers), and 14 percent earned less than $7,000 (9 percent generally).[5] Not surprisingly, in view of the discount based on length of tenancy, the average age of the tenant-buyer (43 years) was significantly above the average for first-time buyers (31).

Multi-Unit Buildings

The data indicate that the bulk of public housing sales in Britain have constituted purchases of fairly desirable types of housing to tenants who would not be classified as very poor. So American policymakers should not assume that the typical Right to Buy sale involves a welfare mother buying her high-rise apartment.

Indeed, it is the high-rise apartment that has been the most difficult for local authorities to sell to tenants. British officials are quick to point out, however, that a high proportion of Britain's multifamily urban public housing was built after the Second World War with poor material and designs. Inadequate durability and structural problems make these units very unattractive for purchase, even at low prices. Would-be buyers in such buildings are inclined to remain on the waiting list for a more desirable property (using the waiting time toward a larger discount).

A second key factor is the unfamiliarity of the British with mechanisms such as tenant management or cooperative ownership. Tenant management is almost unknown in Britain, and cooperative ownership is rare. Consequently, say British officials, tenants have a strong resistance to the only forms of purchase and organization that are practical for low-income people in multifamily buildings. Even when a tenant buys his home in a 4-unit walk-up, the local authority usually retains the responsibility for the common areas and general maintenance (with a service fee), rather than have the owners accept this responsibility.

Lessons of the British Model

Despite such differences between the U.K. and U.S. situations, the British program contains important lessons for a workable approach on this side of the Atlantic.

The first is that a discount based on length of tenancy is a powerful stimulus and a means of favoring the most stable tenants.

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5 Assuming one pound = $1.40.

Initial fears that the discounts would provoke anger among working class buyers of private homes (who enjoy no such discount) proved groundless. The discount strategy has enabled many long established tenants to become even firmer anchors in the community.

A second lesson is that the resale value recapture mechanism is an important ingredient of the British program. It discourages rapid resale--which would undermine the otherwise stabilizing features of the program. On the other hand, the prospect of capital gain is important to a purchaser. In neighborhoods where market prices are not rising, or even falling, the sliding scale recapture provision in Britain allows for a potential capital gain within a reasonably short time.

The third lesson is that an American version of the British plan would have to overcome the problem of selling apartments to low-income tenants. Given the familiarity of Americans with cooperative ownership, this should present fewer problems than it has in Britain. Nevertheless, the high concentration of low-income people in American public housing would require more creative financing arrangements than are typical in Britain.

A PROGRAM FOR THE UNITED STATES

Since 1949, Congress has targeted the public housing program increasingly toward lower-income and welfare families, rather than those with modest incomes. Unlike Britain, therefore, the family income of a typical American public housing tenant is well below the national median--posing problems for any sales policy. Legislation does give a Public Housing Authority (PHA) in the United States the power to sell a "low income project to its lower income tenants." The sale price is usually based on the portion of the original development cost still outstanding--not the current market value. So discounted sales are permissible in the U.S.

This and other legislation have led to a number of home ownership programs for low-income tenants. The Turnkey III program, begun in 1968 and terminated in 1973, used the PHA framework to develop housing projects for sale, on a lease-purchase basis, to groups of public housing tenants with sufficient incomes to permit a sale without continued operating subsidies. The price was based on the total original development costs, and if the buyer were to resell the unit within five years of receiving full title, the PHA was entitled to recapture the capital gain according to a sliding scale. A requirement for success was the ability of the buyer to undertake basic maintenance and to accept the financial and other obligations of ownership.

Similar problems arose with the Section 235 Homeownership Program, another major federal initiative to encourage low-income homeownership through the sale of new or extensively rehabilitated units. The income problem was compounded in the case of Section

235 by the low (3 percent) down payment requirement--which could be in the form of "sweat equity" (that is, provided in the form of on-site work rather than cash). This meant that the loan-to-value ratio could easily come to exceed 100 percent in an unstable neighborhood--encouraging others to abandon their properties at the first need for substantial maintenance outlays.

The most extensive and perhaps most interesting low-income ownership program, however, has been the Indian Mutual Help Ownership Opportunity Program, which constitutes 61 percent of HUD assistance in Indian areas. Families or tribes must make a down payment contribution of at least $1,500 toward each unit, in the form of cash, land, or work. The resident can acquire title to the unit, generally after 25 years, through a lease-purchase plan that allows equity to be built up gradually. The program has been very popular and effective, covering over 30,000 units.

Mutual housing associations (MHAs), as a homeownership vehicle for public housing tenants, have attracted considerable attention in recent years. Proposals are now being formulated in Patterson, New Jersey, for example, which would use the model to transfer 242 public housing units into tenant ownership. The title of the building first would be transfered to a mutual housing association made up of residents. This MHA would be affiliated to a city-wide MHA with a board of directors drawn from city officials and local organizations. This city-wide MHA could enlist support and provide technical assistance for would-be buyers, thereby improving the chances of successful ownership by individuals, who would be able to purchase title from the MHA.

THE PRINCIPLES OF A NEW OWNERSHIP INITIATIVE

Drawing on British and American experience in encouraging ownership among low-income tenants, principles for a successful homeownership program for public housing tenants emerge. Among them:

1) Discounts and Equity

It is clear from the problems associated with Section 235, and in contrast, the success of the British approach, that buyers must feel they have sufficient stake in their homes to justify expenditures on maintenance. Discounting the price (giving the prospect of a substantial capital gain) would provide that stake indirectly but effectively: a token down payment does not.

Current law permits HUD to sell to a resident tenant at a discount with the federal government paying off part or all of the existing capital debt. Similarly, units can be modernized without the tenant-buyer being required to pay the cost of modernization.

2) A Subsidy to Buyers

Some critics of discounted sales to low-income buyers charge that this constitutes an unfair valuable subsidy to the buyer. These critics overlook the mortgage deduction available to middle- and upper-income buyers--which is of little value to low income buyers. If the purpose of Treasury assistance is to help homebuyers, then a price discount on public housing would be a rational and equitable device to help low-income buyers. Depending on the discount chosen and the tax savings (if any) usable by purchase, a case could also be made--again on equity grounds--for some interest relief for low-income buyers. It would be reasonable for the interest payable on PHA-provided mortgages to be reduced by an amount at least equal to the lowest marginal federal tax rate.

3) Netting for Other Subsidies

Subsidy calculations should also be adjusted for the subsidies to other groups already included in the cost of public housing. American Enterprise Institute scholar John Weicher notes that studies suggest that new public housing units cost about 25 percent more than comparable private housing. The major reasons for this are the high tax revenue costs associated with tax-exempt financing often used in such projects (a subsidy to higher-income investors) and high construction costs due to the application of the Davis-Bacon Act (a subsidy to construction workers).[6] There seems little justice in forcing low-income homebuyers to cover the capital cost of a subsidy to Americans earning well above their income. The cash basis for any calculation of purchase price, therefore, should net out such subsidies.

4) Developing Homeowner Attitudes

A major problem associated with low-income buyers, even if financing can be arranged, is that they often lack the maintenance and accounting skills needed for homeownership. On the other hand, some remarkable successes have been achieved with tenant management associations as vehicles to encourage sound maintenance techniques--especially when cash incentives were utilized. As head of Newark's public housing in the 1970s, for instance, Tom Massaro sought to cut costs by inviting tenants to take over many responsibilities. For every dollar this saved the city, the tenants were allowed a portion to finance community activities. The result: vandalism and utility costs plummeted and tenants acquired useful maintenance skills.

Another tenant management association in Kenilworth Courts, Washington, D.C., has achieved dramatic cost reductions by training

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6 John C. Weicher, Housing (Washington, D.C.: American Enterprise Institute, 1980), p. 59.

its own tenants in management and maintenance skills. A preliminary study by the American Enterprise Institute's Neighborhood Revitalization Project found that within one year of the 1982 turnover to tenant management, administrative costs were cut by 63 percent, and maintenance (the major outlay) by 26 percent. In addition, rental income was increased significantly, thanks to improved collection and reduced vacancy rates, such that the project began to run a healthy operating surplus.

Success as a tenant management asssociation could be a sensible prerequisite to apply to a group of public housing tenants wishing to purchase as a cooperative. An alternative requirement would be the creation of a private Mutual Housing Association, as that suggested in Patterson, New Jersey, to provide management assistance and training to achieve operating cost reductions. The tenants would be members of this association, which could foster cooperative or any other suitable form of tenant ownership. Another equity-building approach would be for the tenants to enter into a lease-purchase agreement. The operating subsidy would then be capped, and savings achieved by the tenants would be accumulated as equity shares until the full purchase could be accomplished, whereupon title would be transferred.

The savings achievable through tenant management is critical both to the success of any ownership plan and to the number of tenants that could hope to utilize it. Most studies of the potential for ownership among public housing tenants suggest that it is very small. But these calculations ignore the substantial reductions in cost that can be achieved--if tenants have an incentive--and thus grossly underestimate the possibilities of ownership.

A PUBLIC HOUSING HOMEOWNERSHIP PROGRAM

The Administration, utilizing existing law and with the agreement and cooperation of communities and PHAs, should experiment with a homeowner program for public housing tenants. The President should make it clear that the objective is not to raise income but to promote ownership in poor communities. Special buildings for the elderly or the handicapped should be excluded from the program, so that the number of such units available for rent would not be reduced.

In addition, Congress should enact a "Public Tenants Right to Buy Program." The measure should give groups of tenants the right to be included in the homeownership program, even if the local PHA opposes ownership. Such a group of tenants would apply directly to the Secretary of HUD. If eligible, according to the criteria below, HUD would set in motion the ownership process, and the PHA would be required to provide the resident association with a mortgage according to HUD rules. Legislation should also be enacted to expand the housing voucher program so that tenants unable to buy a share of a co-op, or other ownership vehicle, such as lease-purchase, could continue as renters.

Eligibility

The program would center generally on purchases by successful tenant management associations. As the tenant management associations or mutual housing associations improved tenant skills and reduced operating costs, savings to the PHA would be placed into an escrow account toward the purchase price, or as the equity element of a lease-purchase agreement. The purchase process would begin when this transitional arrangement reduced running costs sufficiently for the tenants to have a reasonable chance of meeting the costs of ownership.

To be eligible for membership in the purchasing organizations, tenant-buyers should have been good tenants in the specific building for at least one year and good public housing tenants for at least three years. This would help assure stable buyers of good character. Tenants unable to meet this criterion would not be permitted to purchase.

Discount and Resale

An eligible association, comprised of eligible tenants, would be allowed to purchase the building at 30 percent of the assessed market value. No down payment would be required. If a co-op member were to sell his share within the one year, his portion of the entire 70 percent discount would be repayable to the PHA. This repayable portion would fall by 10 percent annual segments (of the initial market price) until, after seven years, the member would be free to keep all resale proceeds. The prospect of gain should be sufficient to establish the notion of equity, and so offset the lack of a down payment.

Financing

Eligible tenant management associations accepted into the program would have the right to a mortgage from the PHA under the legislation proposed. Since the PHA would be the owner of the building in the first place, this would involve no transfer of cash, only the replacement of rent payments to the PHA with mortgage payments. The interest rate on the mortgage would be adjusted to reflect the marginal tax benefits available to typical first-time homebuyers.

Tenant associations could purchase outright or purchase according to a shared-equity plan. With either method of purchase, the housing authority would continue to operate the units occupied by tenants refusing or ineligible to join the ownership associations. Existing tenants, in other words, would not be evicted. Eligible tenants could, however, buy into the purchase plan at any time. If some of the tenants continued to remain renters, supported by the government, that portion of the building would be considered a set of units owned by the PHA--thus the PHA would not be a shareholder in the cooperative. However, maintenance services to these units could be provided by the tenant ownership association under contract. An alternative might be for the federal government to guarantee to the association owning the building that vouchers would be provided to meet the costs of units still occupied by tenants.

Under a shared-equity arrangement, the tenant association could, in effect, buy a portion of the unit (minimum 50 percent) and continue to pay rent to the PHA on the remainder. The association could add to its ownership in increments, as finances permitted. Payment could be made in-kind (such as maintenance work) to obtain additional ownership shares. An alternative approach would be a lease-purchase arrangement, where tenants could build up equity credits, but would not take title until they could finance the entire sale price of the building.

Resale

The part-owner could sell his unit in the normal way, subject to the provisions regarding discount repayment, but he would have to return the original cost of the rented portion of his unit to the PHA. Alternatively, he could sell his share to an eligible buyer willing to take on his shared equity responsibilities. The tenant would have the right to a mortgage from the PHA, with a limit based on income and a below-market interest rate, offsetting the reduced tax relief available to low-income tenants.

CONCLUSION

The program suggested is not a proposal to sell off public housing to developers or suburban homesteaders. It is a device to provide ownership opportunities for existing tenants of public housing projects. If successful, it could transform some of the most troublesome communities in the nation's urban areas. It draws on the known successes of tenant management associations and that powerful ingredient of commitment to neighborhood--ownership. Turning public housing tenants into homeowners in this way would utilize the strengths and ownership dreams of residents themselves to help overcome the debilitating problem of America's inner cities.

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