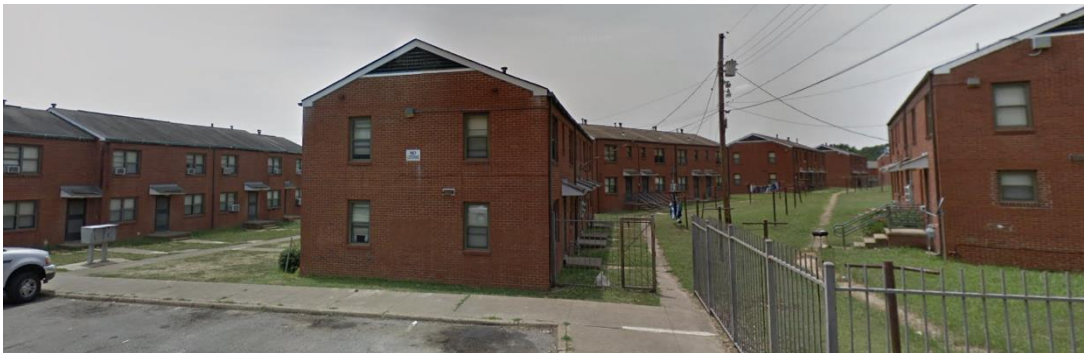


# Recognizing Functional Obsolescence in Determining Eligibility for Public Housing Demolition and Disposition

By

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## Introduction

In 2020, the **RAD Collaborative**, and industry organization committed to preserving and revitalizing public housing projects, suggested various reforms governing the demolition and disposition of public housing to help public housing authorities (PHAs) better reposition their inventories, especially for projects built in the earlier decades of the program.<sup>1</sup> We return to that subject in this paper, focusing on the need to recognize a project’s functional obsolescence in determining its eligibility for demolition or disposition, which would be in the best interests of residents, PHAs, affected communities, and HUD.

## An Illustration

The images appearing on the cover of this paper are of an existing public housing project built in the 1950s.<sup>2</sup> The units are cramped and lack adequate kitchen, bathroom, living room, or closet space. There is no air conditioning or sufficient electrical supply for modern appliances. The utility systems are exposed, with surface-mounted conduit, and the interior walls are painted mason blocks. There is also a lack of energy efficiency, with inadequate insulation of the exterior walls and roofing, or accessibility features.

Outside the units, the buildings are arranged in barracks-style, mostly without orientation to the street and with numerous indefensible spaces. There is inadequate parking, refuse collection, access for EMS, site connectivity, handicap accessibility, or community recreational spaces. The buildings are spartan in appearance, without any significant definition between the front and rear. The overall site plan fails to allow exterior personal space or engender place-making characteristics and the project’s scale contrasts sharply with the adjacent residential neighborhood.

Not surprisingly, over time, the project has become housing of last resort, i.e., a place of concentrated poverty, with high rates of crime and turnover. However, HUD’s standards for obsolescence – which affect the ability to demolish or dispose of public housing and the receipt of Section 8 Tenant Protection Vouchers (TPVs) – fail to recognize any of the conditions mentioned above. In determining obsolescence, HUD applies a physical cost test that only considers what is broken or needs repair. But for this project, and for much of what was built in public housing’s early years, simply fixing the “as-is” condition will do nothing to transform this community and end its social and economic isolation.

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<sup>1</sup> See: [What PHAs Need to Finish the Task 8-14-20.pdf \(d1a8dioxuajlzs.cloudfront.net\)](#) and [RC-Q&A+Accelerating+the+Job+Final+11-01-20.pdf \(squarespace.com\)](#) .

<sup>2</sup> Google Maps, 2022. Map and Street View Image of the Lincoln Courts Neighborhood, <https://www.google.com/maps/>

## A Definition

Although functional obsolescence, particularly for our oldest public housing, seems self-evident, we suggest that it could be defined as:

*Certain design and project characteristics that result in significant challenges to the efficient operation and livability of the project or in the ability to attract a broad range of low-income households.*

The above definition would recognize that context is important. An undistinguished project with small unit sizes in a high opportunity area may still be desirable, whereas a project in a low-income neighborhood with small units, a bleak design, indefensible spaces, etc., will likely attract only the most destitute.

## Background

In 1992, the *Congressional Commission on Severely Distressed Public Housing* estimated that there were some 86,000 “severely distressed” public housing units nationally, leading to the enactment of the *HOPE VI Program* (1992) and its successor, the *Choice Neighborhoods Initiative Program* (2009).<sup>3</sup> To further aid PHAs in dealing with distressed projects, Congress also recognized the need to address *Section 18 of the Housing Act of 1937*, requiring that any public housing demolished or disposed had to be replaced on a one-for-one basis. Because there was no active public housing development program (then or now), PHAs were stuck with many terrible projects, affecting not just the lives of residents but also the neighborhoods surrounding those ailing projects. As a result, in 1998, through the *Quality Housing and Work Responsibility Act (QHWRA)*, Congress amended Section 18 to permit the demolition or disposition of any public housing project (or portion of a project), without any hard unit replacement requirement, determined to be obsolete as to physical condition, location, or other factors that would make it unsuitable for housing purposes and where no reasonable program of modification would be cost-effective to return the property to its useful life.<sup>4</sup>

In implementing the QHWRA changes to Section 18, except for cases involving obvious health and safety (for example, a property located in a recognized floodway), HUD opted for a physical cost test as the means of determining obsolescence. Any project with immediate repair needs exceeding the hard costs of building a new unit would be considered obsolete and could be

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<sup>3</sup> Congress established the National Commission on Severely Distressed Public Housing through the *1989 National Affordable Housing Act* (Public Law 101-235; 103 Stat. 2048) of December 15, 1989. The Commission submitted its final report to Congress and the Department of Housing and Urban Development on August 15, 1992, proposing a National Action Plan to eradicate severely distressed public housing by 2000. The Commission estimated that 6% of the public housing stock had repair needs in excess of HUD’s Housing Construction Costs (HCC) standards for new construction, with the estimate to cure in 1992 of approximately \$5.6 billion (or \$11.6 billion in today’s dollars).

<sup>4</sup> The QHWRA statute had slightly different language for eligibility for demolition vs disposition, but HUD has essentially treated both actions similarly.

removed with no obligation on the part of the PHA to replace it.<sup>5</sup> But this physical cost test only considered the expenses to remedy the *as-is condition* of the building, meaning repair costs only include building items that are expired, broken, or non-operational. A PHA cannot include any “betterment” costs, such as adding a second bathroom to a four-bedroom unit, installing air conditioning in warm climates, improving vehicular circulation, or correcting any other characteristics that may make the project functionally obsolete. So rigid is the current physical cost test that a PHA cannot include the costs for replacing systems that are operational but near the end of their useful life (e.g., windows and boilers) for more energy-efficient equipment, which would ultimately benefit residents and HUD alike. This basic “fix as-is” standard, comparing only the costs of qualified repairs to the cost of new construction, remained until 2018, when HUD added some new categories of Section 18 eligibility.

## The 2018 Modifications

As part of PIH-Notice 2018-04, *Demolition and/or disposition of public housing property, eligibility for tenant-protection vouchers, and associated requirements*<sup>6</sup>, HUD added the following additional eligibility categories to Section 18:

- **Scattered Sites** – Influenced by the number of Section 18 applications it had received from PHAs struggling to maintain scattered site units, HUD provided a new special category of Section 18 eligibility specifically for scattered site units. If, due to distance between units and lack of uniformity of systems, the units are unsustainable to operate and/or maintain as public housing, the units can be removed through Section 18 without any physical cost test.<sup>7</sup>
- **PHAs with 50 or Fewer Public Housing Units** – Recognizing the burden that very small PHAs have in keeping up with public housing’s myriad of program requirements (as well as the challenge to HUD in monitoring these mostly rural agencies), HUD extended a new blanket category of Section 18 eligibility to any PHA with 50 or fewer units. These very small PHAs can now exit the public housing program, and either offer affected residents vouchers or seek to project-base those vouchers.
- **RAD/Section 18 Small PHA Close-out Blend** – To encourage PHAs with 250 or fewer public housing units (“small PHAs”) to convert to Section 8, but also for HUD to achieve greater program consolidation, HUD further broadened Section 18

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<sup>5</sup>Hard repair costs must exceed 62.5% of HUD’s published “Total Development Cost (TDC)” limits for elevator buildings and 57.14% for non-elevator buildings, also known as “Housing Construction Costs” or HCC.

<sup>6</sup> Notice PIH 2018-04 (HA), Issued March 22, 2018, revised July 3, 2018, and December 14, 2018. The purpose of the notice was to explain application requirements to request HUD approval to demolish and/or dispose of public housing property under Section 18 of the *United States Housing Act of 1937* and related TPV eligibility.

<sup>7</sup> For purposes of notice PIH 2018-04, scattered site units generally mean units in non-contiguous buildings with four or fewer total units.

eligibility by allowing 80% of the units in a RAD transaction to be replaced with Section 18, provided the (small) PHA agrees to close-out its public housing program.

- **RAD/Section 18 Construction Blend<sup>8</sup>** – And, finally, to reward PHAs undertaking significant levels of repairs under the *Rental Assistance Demonstration (RAD)* program without 9% low-income housing tax credits, HUD allowed between 20% and 80% of the public housing units in a RAD transaction to be removed through Section 18, depending on the level of repairs and whether the project is in a high-cost area.

These 2018 modifications have been well-received within the public housing community as they have provided a greatly expanded and expedited route to the Section 8 platform. They suggest a recognition that, under the broader context of asset management, different types, configurations, and levels of capital needs in public housing warrant more flexibility. Heretofore, Section 18 had pretty much been a one-size-fits-all approach to asset management, contrasting sharply with norms in traditional multifamily housing. Importantly, these 2018 amendments also demonstrate the enormous discretion HUD has in determining Section 18 eligibility without imposing any associated physical cost test.<sup>9</sup>

### **The Accompanying Availability of Section 8 Tenant Protection Vouchers (TPVs)**

For each Section 18 removal action, subject to some refinements over the years, HUD provides Section 8 “Tenant Protection Vouchers,” or TPVs. The primary purpose of these TPVs is to protect tenants from having to live in unfit conditions by giving them the means to secure better housing. However, tenants may voluntarily move to other public or comparable-assisted housing, if available. TPVs also help to ensure that a community is made whole in terms of the number of assisted units, even if there is a shift from hard to soft units.

Increasingly, though, PHAs are finding a new purpose for TPVs, which is as a preservation tool. By project-basing the TPVs, PHAs have found ways to either preserve (but upgrade) the existing structure or help finance the construction of new, hard replacement units. Indeed, the *2016 Housing Opportunity through Modernization Act (HOTMA)* added several provisions specifically designed to make it easier to project-base TPVs awarded with Section 18 approvals.<sup>10</sup> Project-

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<sup>8</sup> These RAD/Section 18 construction “blends” were introduced in 2018 and expanded in 2021.

<sup>9</sup> PIH Notice 2018-04 also clarified the criterion relating to what is meant under the Section 18 statute as “infeasible operation” (basically, there is no rental demand for the unit) or what qualifies as “more efficient and effective housing” (allowing units to be removed as long as the PHA can replace some of the units with “better” housing but, in exchange for this simplified standard, HUD will only provide Section 8 Tenant Protection Vouchers for 25% of the units, which is rarely an enticing option).

<sup>10</sup> These include exempting former public housing projects from PBV income-mixing requirements and from the cap on the number of voucher units that can be project-based (the “program cap”).

based TPVs are now a central element of just about any public housing redevelopment effort. (Note: To further facilitate these preservation and regeneration efforts, Congress should consider amending the Section 8 PBV rules to allow, in the case of public housing redevelopment projects, rents up to 120% of the Fair Market Rent (FMR). Today, with FMRs mostly set at the 40th percentile of rents in a market, and with PBV rents capped at 110% of FMR, the PBV rents barely represent the median rent in a market. Increasing these rents up to 120% of FMR would be a reasonable and incremental means of helping to address the obsolete project problem.)

## **Public Housing’s Remaining Legacy Inventory**

As it turns out, the *Commission on Severely Distressed Public Housing* greatly underestimated the inventory of distressed or obsolete projects. Since 1998, around 300,000 units have been removed through Section 18 (of which about 80,000 units were replaced with new public housing units, mostly through the HOPE VI program). The bulk of this activity occurred from 1998 to 2007, after which the pace dropped dramatically (only about 50,000 units have been removed through Section 18 since 2007).

Despite the significant thinning out of the public housing inventory, mostly in the two decades following the 1998 QHWRA legislation, there are still more than 200,000 public housing units remaining that were built in the 1930s, 1940s, and 1950s, which is the period of time most commonly referred to as public housing’s “legacy” era.<sup>11</sup> Projects from this era, as illustrated earlier, were developed under a particular set of program design, construction, and cost standards that, today, render many of them functionally obsolete.<sup>12</sup> Correcting any one of the conditions – say, the cramped kitchens, energy efficiency, or the lack of parking – becomes enormously expensive and often cannot be done without a major redesign of the project.<sup>13</sup>

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<sup>11</sup> The dividing line in establishing public housing’s legacy era is admittedly imprecise. It is widely recognized that the design criteria improved markedly in the 1960s, adopting more of the standards of traditional multifamily housing.

<sup>12</sup> For more information on this subject, see page 78 of the Final Report of the *National Commission on Severely Distressed Public Housing*, “Design Factors Contributing to Distress,” August 1992.

<sup>13</sup> Other characteristics common to projects built in this era include master utility and associated PHA-owned distribution systems; lack of central air conditioning; insufficient electrical capacity; poor crawl space construction; insufficient thermal envelope; and a myriad of environmental concerns (lead-based paint, asbestos, radon, mold).

**Number of Existing Public Housing Units Constructed by Decade<sup>14</sup>**

<b>Decade</b>	<b>2020 Units</b>	<b>Percentage</b>
1930s	7,336	1%
1940s	69,975	7%
1950s	125,358	13%
1960s	232,470	23%
1970s	355,736	36%
1980s	105,968	11%
1990s	36,095	4%
2000s	33,594	3%
2010s	24,604	2%
2020s	109	-
<b>Total</b>	<b>990,245</b>	<b>100%</b>

## **Why it Matters**

The failure to recognize functional obsolescence in determining eligibility for demolition or disposition has had three major consequences:

- First, it has greatly increased the administrative cost associated with a Section 18 application, both the direct cost of the physical needs assessments and the indirect costs of negotiating with HUD over those submitted costs. Rather than wasting time attempting to document the obvious, we should concentrate efforts on helping to plan for the redevelopment of these sites.
- Second, it has served to relegate many legacy projects to a perpetual state of undercapitalization. In an effort to ensure basic habitability and health and safety, PHAs may undertake certain repairs (say, new roofs) that may then disqualify the project for obsolescence under the current physical cost-test, forcing the project to limp along when a larger, more comprehensive redevelopment effort is needed.
- Third, it has greatly hampered local planning efforts to help transform these legacy communities. The current Section 18 approval process introduces too much uncertainty. A PHA cannot be sure if a project will qualify under the physical obsolescence test. To successfully redevelop these communities, a PHA needs carefully to plan and sequence stakeholder engagements, tax-credit funding, gap financing, resident relocation, etc. The risk of not getting a project approved under the current obsolescence test can be devastating to managing these relationships and the sequencing of tasks, deterring

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<sup>14</sup> As reflected in HUD's Public and Indian Housing Information Center (PIC). Data as of 2020.

PHAs from applying under Section 18.<sup>15</sup> It would be far better for each PHA, and each community, to know from the outset that projects from this era, or with these functionally obsolete conditions, are eligible for obsolescence – and, therefore, are also eligible for Section 8 TPVs. It would take the guesswork out of legacy project planning and greatly help PHAs move on from the current situation.

The net effect is that these functionally obsolete projects are mostly unsafe, often with working but unreliable systems, that trap the most desperate, deter school attendance, squash community connections, discourage any sense of pride or hope, and generally end up harming residents when the alternative of receiving a voucher or redeveloping the property with the aid or project-based TPVs would translate into better life outcomes.

### **How to Incorporate Functional Obsolescence in HUD’s Section 18 Eligibility Determinations**

How would this work? One approach would be to allow PHAs to include the costs of correcting functional obsolescence when determining a project’s physical needs. This approach would be helpful but also arduous. Another, more practical approach would be to recognize that projects either built during public housing’s legacy era, or built with certain characteristics from that era, are de-facto obsolete, just as HUD has done for, say, scattered sites or PHAs with 50 or fewer public housing units. The latter would recognize the obvious, which is that legacy-style projects are obsolete and that we should be giving PHAs as many tools as possible to re-work them. In any event, it should not prove difficult for HUD and the public housing industry to agree to some standard for functional obsolescence.

### **Conclusion**

This paper has focused on a narrow but important part of the broader discussion surrounding how best to support the necessary repositioning of public housing, suggesting that the criteria governing the demolition and disposition of public housing should include functional obsolescence, possibly a universal classification for legacy projects, however defined. For these legacy projects, the goal should not be to return them to their as-built condition but to replace them with modern, desirable, and climate-resilient housing. To do so effectively, we need to recognize their current state of functional obsolescence. A functional obsolescence standard would enhance PHA planning efforts to support more appropriate preservation of the stock – mostly via viable replacement housing – which, in turn, would improve tenant living conditions;

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<sup>15</sup> Dominion Due Diligence Group (D3G) has completed physical needs assessments of more than 120 legacy projects in connection with Section 18 demolition and disposition applications. Where only modest capital improvements were made over the years to these properties, 95% of the applications were approved (met the obsolescence cost test). But if the PHA had been able to replace major building systems, the ability to meet the physical cost test, despite the project’s functional obsolescence, was less certain.



spur neighborhood investment; and otherwise be consistent with HUD's other efforts in recent years to recapitalize public housing.

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