

**Performance Audit of the
City's Assumption of the San Francisco Housing
Authority's Essential Functions**

Prepared for the

**Board of Supervisors
of the City and County of San Francisco**

by the

San Francisco Budget and Legislative Analyst

September 9, 2019

BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

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September 9, 2019

Supervisor Gordon Mar, Chair, Government Audit and Oversight Committee
and Members of the San Francisco Board of Supervisors
Room 244, City Hall
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4689

Dear Supervisor Mar and Members of the Board of Supervisors:

The Budget and Legislative Analyst is pleased to submit this *Performance Audit of the City's Assumption of the San Francisco Housing Authority's Essential Functions*. In response to a motion adopted by the Board of Supervisors in December 2018 (Motion No. 18-163), the Budget and Legislative Analyst conducted this performance audit, pursuant to the Board of Supervisors powers of inquiry as defined in Charter Section 16.114 and in accordance with U.S. Government Accountability Office (GAO) standards.

The purpose of the performance audit was to evaluate the transition of the Housing Authority's essential functions from the Housing Authority to the City. The Mayor's Office of Housing and Community Development (MOHCD) Acting Director, and the City's Transition Team Leader provided a written response to our audit report, attached to this report beginning on page 43.

According to the written response, the MOHCD Acting Director and Transition Team Leader agree with 12 of the audit recommendations and disagree with four recommendations.

- The MOHCD Acting Director and Transition Team Leader disagree with Recommendation 4, which states that the Board of Supervisors should request the Mayor and the Acting Executive Director of the Housing Authority to negotiate with the U.S. Department of Housing and Urban Development (HUD) on the Housing Authority's accountability to the Board of Supervisors in conformance to the City Charter and Administrative Code, including annual budget review consistent with HUD requirements, contract and lease approvals above relevant thresholds, and property transactions to confirm conformance with the terms of the respective development agreements.

According to the written response from the MOHCD Acting Director and Transition Team Leader, "HUD directly funds the Housing Authority and requires that its relationship remains only with the Housing Authority and its Commission. The Transition Team and MOHCD have confirmed that HUD will not permit the Board of Supervisors or other city departments to have approval authority over transactions that use HUD funding and are approved by HUD and the Housing Authority's Commission."

We continue to recommend Recommendation 4. As noted on page 25 of our report, "both because of the increased financial risk assumed by the City and because of the potential impact to San Francisco residents, the Board of Supervisors oversight of the Housing Authority's functions should be included in negotiations with HUD...Because the City will assume accountability for Housing Authority finances and operations, the Housing Authority will

effectively function like a City department. Negotiations with HUD should include consideration of how standard reporting and governance procedures for City departments, as codified in the City Charter and Administrative Code, would apply to the Housing Authority.”

The written response from the MOHCD Acting Director and Transition Team Leader further states that “any city action related to an already-approved agreement (lease, development agreement, or other contract) cannot deviate from what the City, the Housing Authority, and HUD agreed to in their agreements”.

However, as noted on page 26 of our report, “the City should negotiate with HUD to include in the proposed MOU between the City and the Housing Authority that all property transactions be submitted to the Board of Supervisors to *confirm conformance with the terms of the respective development agreements* (italics added). While this provision would not change any of HUD’s authority in disposing of Housing Authority property, it would ensure that Housing Authority property is sold to private parties through an open and competitive process and in conformance with the development agreements”.

- The MOHCD Acting Director and Transition Team Leader disagree with Recommendation 5, which states that the Board of Supervisors should adopt an ordinance to amend Chapter 12, Section 12.2 of the Administrative Code to codify the Housing Authority Commission structure adopted by the Board.

According to the written response from the MOHCD Acting Director and Transition Team Leader, “under the California Health and Safety Code, Section 34270.1, the mayor has the sole authority to appoint all seven commissioners.”

We continue to recommend Recommendation 5. As noted on page 23 of our report, “the proposed Memorandum of Understanding (MOU), submitted to the Board of Supervisors for approval on July 19, 2019, proposes a seven-member Commission consisting of four members appointed by the Mayor directly and three members recommended for appointment by motion of the Board of Supervisors”. Our recommendation simply codifies what the proposed MOU sets forth, and would not conflict with the California Health and Safety Code. We continue to recommend that the Commission structure, as proposed in the terms of the MOU currently before the Board of Supervisors, be codified in the Administrative Code once adopted.

- The MOHCD Acting Director and Transition Team Leader disagree with Recommendation 11, which states that the Controller should ensure that the Housing Authority transitions over to the City’s financial system following the transitional phase of the restructuring; and Recommendation 12, which states that “the Controller should have the same authority to serve as the Controller to the Housing Authority as he does other City departments and agencies.

According to the written response from the MOHCD Acting Director and Transition Team Leader, “the City’s financial system is not designed for public housing agencies and is not equipped with specialized functionalities to track vouchers or maintain tenants’ leasing activities, which are required to be reported to HUD. As such, the Transition Team and MOHCD believe it is best for the Housing Authority to retain its current financial systems until a compatible alternative system is identified. Any such system must meet HUD’s financial reporting and voucher management requirements.”

The written response further states that “ the Housing Authority must remain a separate legal entity from the City and cannot be considered a component of the City or any other primary government, as defined by the GASB (Governmental Accounting Standards Board), as its Commission independently oversees its operations. The Housing Authority is subject to HUD’s financial reporting, budget, and voucher management requirements, which are distinct from the City’s financial processes. Also, the Housing Authority uses a different fiscal year (October 1st to September 30th) than the City does.”

We continue to recommend Recommendations 11 and 12, which supports the transition plans as described in the proposed MOU. As noted on pages 33 and 34 of our report, “the proposed MOU submitted to the Board of Supervisors on July 9, 2019 provides for the Housing Authority to transition to a shared services model, in which the City provides services to the Authority, including human resources, information technology, purchasing, real estate, and financial systems and oversight. According to the proposed MOU, the Housing Authority in conjunction with MOHCD, the Controller’s Office, and the General Services Agency will develop a timeline for integrating systems, processes, and policies.” As we state in our audit report on page 34, transition to the City’s new financial system is especially important so that the Controller’s Office has direct access to the agency’s information and can provide adequate oversight to ensure quality control and accuracy.

We would like to thank the Housing Authority Acting Director and her staff, MOHCD Acting Director and his staff, and the Transition Team Leader for their assistance during this performance audit.

Respectfully submitted,



Severin Campbell, Director
Budget and Legislative Analyst’s Office

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|----------------------|---|
| cc: President Yee | Mayor Breed |
| Supervisor Brown | MOHCD Acting Director |
| Supervisor Fewer | SFHA Acting Director |
| Supervisor Haney | Transition Team Leader |
| Supervisor Mandelman | Controller |
| Supervisor Mar | President, Housing Authority Commission |
| Supervisor Peskin | Clerk of the Board |
| Supervisor Ronen | City Attorney’s Office |
| Supervisor Safai | Mayor’s Budget Director |
| Supervisor Stefani | Controller |
| Supervisor Walton | President, Housing Authority Commission |

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Executive Summary

In the fall of 2018, the Housing Authority was discovered to have up to a \$30 million shortfall in the Housing Choice Voucher program. To close the shortfall, the City provided a forgivable loan of up to \$20 million, of which the Housing Authority spent \$10.3 million. The Department of Housing and Urban Development (HUD) has since provided the Housing Authority with \$6.2 million to reimburse City loan funds that had been spent on the CY 2018 shortfall.

The estimated \$30 million shortfall resulted from an increase in the number of Housing Choice Vouchers, and inadequate financial reporting and projections. In March 2019, HUD determined that the Housing Authority was in substantial default under the Housing Choice Voucher and public housing programs. According to HUD's March 2019 default notice, HUD has the authority to place the Housing Authority in receivership, taking possession of all or part of the Housing Authority. HUD agreed, as an alternative to receivership, that the Housing Authority could remedy the default through the City's assumption of the Housing Authority's essential functions. As part of the City's assumption of the Housing Authority's essential function, the Housing Choice Voucher program and public housing program were to be contracted to third parties.

San Francisco is at risk to have insufficient HUD funding in the future to pay all housing voucher program costs

HUD funds housing vouchers for low income households through Housing Assistance Payments to the Housing Authority. Housing vouchers are both tenant-based through the Housing Choice Voucher program (formerly Section 8) which allows households to access housing in the local market, and project-based, which funds housing projects. The total Housing Assistance Payment authorized by HUD at the beginning of the calendar year is determined by the average monthly expenditure from the *prior* calendar year adjusted by an inflation factor, which results in a structural funding deficit in high cost markets such as San Francisco. HUD sets aside funds each year to cover anticipated deficits, which are awarded on a first-come, first-serve basis. While the Housing Authority received \$10 million in supplemental funding for CY 2018, because of the Housing

Authority's financial reporting deficiencies, the Housing Authority did not recognize the full amount of the up to \$30 million shortfall.

Recommendation 1: The Board of Supervisors should request MOHCD and the Housing Authority to report at least once per year to the Board of Supervisors after the December close on the level of funding of the housing voucher program.

San Francisco is at risk to have insufficient HUD funding in the future to pay all housing voucher program costs. BDO, which is currently serving as the Housing Authority's financial accounting and reporting entity, estimates that the average funding shortfall could range from \$16.2 million to \$18.4 million per year between CY 2019 and CY 2031. According to the Mayor's Office of Housing and Community Development (MOHCD), HUD has indicated that it can cover the housing voucher program shortfall in 2019. The funding shortfall in future years could be partially offset by supplemental funding from HUD, but the City would need to apply in sufficient time each year to be eligible for supplemental funding.

Recommendation 2: The Board of Supervisors should request the Mayor, Controller, and Budget and Legislative Analyst, when preparing the City's five-year financial projections, to consider potential reductions in Housing Assistance Payments to the Housing Authority and potential impact to the Housing Trust Fund or City General Fund if the City were to backfill reductions in federal funding.

Recommendation 3: The Housing Authority Executive Director and MOHCD Director should notify the Board of Supervisors regarding the emergence of a funding shortfall that will require supplemental funding from HUD and/or a supplemental appropriation from the City immediately after the cause and amount of these shortfalls become known.

The City should ensure in negotiations with HUD that the City has adequate oversight of Housing Authority operations

Because of the City's increased financial risk in assuming the essential functions of the Housing Authority and potential impact to San Francisco residents, the City should negotiate with HUD on the

Housing Authority's accountability under the City Charter and Administrative Code. In addition, the City should negotiate with HUD to include in the proposed Memorandum of Understanding (MOU) between the City and the Housing Authority that all property transactions be submitted to the Board of Supervisors to confirm conformance with the terms of the respective development agreements. While this provision would not change any of HUD's authority in disposing of Housing Authority property, it would ensure that Housing Authority property is sold to private parties through an open and competitive process and in conformance with the development agreements.

Recommendation 4: The Board of Supervisors should request the Mayor and the Acting Executive Director of the Housing Authority to negotiate with HUD on the Housing Authority's accountability to the Board of Supervisors in conformance to the City Charter and Administrative Code, including annual budget review consistent with HUD requirements, contract and lease approvals above relevant thresholds, and property transactions to confirm conformance with the terms of the respective development agreements.

The proposed MOU proposes a seven-member Commission consisting of four members appointed by the Mayor and three members recommended for appointment by motion of the Board of Supervisors.

Recommendation 5: The Board of Supervisors should adopt an ordinance to amend Chapter 12, Section 12.2 of the Administrative Code to codify the proposal in the proposed MOU to grant the Board of Supervisors the authority to recommend by motion the appointment of three members to the Housing Authority Commission.

The proposed MOU between the City and the Housing Authority gives direction to the restructuring of the Housing Authority but MOU provisions need to be clarified

➤ **The Mayor should prioritize the appointment of the Housing Authority Executive Director**

The proposed MOU between the Housing Authority and the City provides for core functions to be contracted out and Housing Authority operations to be overseen by City staff serving as executive management, including an Executive Director reporting directly to the Mayor or her designee. The appointment of the Executive Director, whose role and accountability is essential to the City's oversight of the Housing Authority's functions, should be a priority.

Recommendation 6: The Board of Supervisors should request the Mayor to appoint an Executive Director for the Housing Authority as a priority.

➤ **The Housing Authority should expedite the disposition of non-housing assets surplus to the Housing Authority's operational requirements**

The proposed MOU submitted provides for the Housing Authority and City to work together to locate Housing Authority operations in City-owned property if space is available. The proposed MOU further provides for the Housing Authority to inventory all non-housing assets and submit to the Controller's Office a plan for disposing of assets not needed for Housing Authority operations. Proceeds from the disposal of assets would be used to repay loans made by the City to the Housing Authority

Recommendation 7: The Board of Supervisors should request the Director of Real Estate to evaluate the space needs for continued Housing Authority operations, and the potential use of 1815 Egbert Street by the City, as part of the plan for disposition of Housing Authority non-housing assets.

➤ **The City needs to ensure the competency and effectiveness of the core the Housing Authority staff**

Some Housing Authority positions will be retained, primarily to manage contract performance for financial and programmatic services. Because inadequate performance of these contracts will have significant impact on the Housing Authority's finances and programs, the new Executive Director must ensure that the staff who fill Housing Authority positions demonstrate the necessary competence for ongoing contract management of the Housing Authority programs.

Recommendation 8: The Transitions Team Leader and Housing Authority Executive Director, once appointed, should ensure that the core Housing Authority positions, particularly the contract managers, demonstrate the necessary competence to perform critical job duties.

➤ **Housing Authority financial services should be integrated with the City's financial systems and oversight**

Once it assumes full responsibility for the Housing Authority's essential functions, and the transition to City oversight has been completed, the City should bring the financial services function in-house to save costs and ensure long-term operations.

Recommendation 9: The Housing Authority Executive Director, once appointed, should, in consultation with the Controller, hire qualified financial staff to assume the duties currently filled through the BDO contract, following sufficient completion of the restructuring.

Recommendation 10: The Housing Authority Executive Director, once appointed, should provide a midyear report to the Board of Supervisors on program and financial performance of all Housing Authority activities, and status of integration of the Housing Authority's systems and policies with the City.

Recommendation 11: The Controller should ensure that the Housing Authority transitions over to the City's financial system following the transitional phase of the restructuring.

Recommendation 12: The Controller should have the same authority to serve as the Controller to the Housing Authority as he does other City departments and agencies.

The sufficiency of the Housing Authority funding for severance payments and unfunded pension liabilities is not clear

The contracting out of the Housing Authority's essential functions, including the Housing Choice Voucher program, as required by HUD, will result in the separation of nearly 200 current the Housing Authority employees. While the City intends to retain 10 to 12 core Housing Authority positions primarily for ongoing contract management, the majority of the Housing Authority employees will either retire or accept a severance package. The estimated costs of severance packages could total \$5 million or more. According to the Housing Authority, reserves will be used for these payments. However, current reserve estimates do not appear sufficient to meet estimated severance package costs, presenting an additional financial risk to the City.

Recommendation 13: The Acting Executive Director of the Housing Authority should work with BDO to evaluate and confirm final projections for reserves that would available for severance payments for exiting employees.

Recommendation 14: The Acting Executive Director of the Housing Authority should consult with HUD to determine whether employee severance payments are an allowable use of reserve funds, in accordance with federal policy.

Recommendation 15: The Acting Executive Director of the Housing Authority should work with the City to identify other possible funding options for severance payments if reserves are insufficient or not eligible for this use.

The Housing Authority will also have continued responsibility for the unfunded pension and OPEB (other post-employment benefits) liabilities of active and former employees, estimated to be \$61.5 million. The Housing Authority will have sufficient net to pay down the unfunded liability over the next five years, resulting in a net liability of \$40.7 million as of September 30, 2023, but will need sufficient net revenues in future years to pay the remaining liability.

Recommendation 16: The Housing Authority Executive Director once appointed, should report annually to the Board of Supervisors on the unfunded pension and OPEB liability and available funds to pay down the unfunded liability.

Introduction

Scope and Methodology

The Board of Supervisors approved Motion 18-163 in December 2018, directing the Budget and Legislative Analyst to conduct a performance audit of the San Francisco Housing Authority's reported financial shortfall that includes a prospective analysis of the City's assumption of all responsibilities for the San Francisco Housing Authority's ("Housing Authority") essential functions, including the role currently performed by the Mayor's Office of Housing and Community Development (MOHCD).

This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards. We held an entrance conference with San Francisco Housing Authority representatives on February 7, 2019 to discuss the scope, timeline, and process of the performance audit, and make an initial request for information.

We interviewed staff from the Housing Authority, MOHCD, Mayor's Office, Controller's Office, U.S. Department of Housing and Urban Development (HUD), and the financial consultants, BDO, to obtain an understanding of the current status of the Housing Authority's financial shortfall and proposals for the City's assumptions of the Housing Authority's essential functions.

We reviewed core documents, including documents detailing the Housing Choice Voucher program; assessments by HUD; financial statements; financial projections developed by BDO; draft memoranda of understanding between the City and HUD; the Housing Authority's contracts with BDO and the asset management contractor, TCAM; and collective bargaining agreements between the Housing Authority and the respective unions.

We provided a draft report on our findings and recommendations to the Housing Authority and MOHCD on July 1, 2019, and held an exit conference with MOHCD on July 10, 2019. We considered information provided to us by the Housing Authority and MOHCD and revised the draft report as needed. We provided the final draft report incorporating these revisions to the MOHCD Acting Director, Housing Authority Acting Director, and Transitions Team Leader on August 15, 2019, and

received their written comments to our findings and recommendations, which are attached to this report on page 43.

San Francisco Housing Authority

The Housing Authority is a local public agency authorized by State law, funded by the U.S. Department of Housing and Urban Development (HUD), and responsible for owning and managing public housing and administering housing vouchers. The Housing Authority is legally separate from the City and County of San Francisco, and funded almost entirely by federal monies provided by HUD. The Housing Authority's FY 2018-19 operating budget is \$65.0 million, as shown in Exhibit 1 below. Operating revenues decreased from \$85.0 million in FY 2015-16 to \$66.6 million in FY 2018-19, largely due to reductions in the allocation to public housing as public housing units are converted to private, non-profit ownership. As a federally-funded agency, the Housing Authority's fiscal year is from October 1 through September 30.

Exhibit 1: San Francisco Housing Authority Operating Revenues and Expenditures, FY 2015-16 through FY 2018-19

Fiscal Year Ending September 30	2016	Actual 2017	2018	Budget 2019 ^a
Operating Revenues				
Public Housing	\$53,134,324	\$32,407,687	\$27,184,101	\$27,186,473
Central Administration	15,896,025	20,658,781	20,872,736	18,427,909
Hope VI	4,297,095	3,986,884	4,193,679	5,475,290
Housing Choice Vouchers	10,294,085	9,014,874	11,968,598	14,495,473
SRO Moderate Rehabilitation/ Other	1,411,179	1,457,466	1,369,435	1,045,610
Total Revenues	\$85,032,707	\$67,525,693	\$65,588,549	\$66,630,755
Operating Expenses				
Public Housing	\$39,742,408	\$23,547,322	\$24,732,413	\$27,186,473
Central Administration	14,420,458	17,324,865	19,956,142	18,427,909
Hope VI	3,377,802	4,114,479	3,392,482	5,270,587
Housing Choice Vouchers	8,876,949	10,178,141	12,299,197	13,723,692
SRO Moderate Rehabilitation/ Other	969,706	1,137,416	1,667,594	430,521
Total Expenses	\$67,387,323	\$56,302,223	\$62,047,828	\$65,039,182
Net Revenues	\$17,645,384	\$11,223,470	\$3,540,721	\$1,591,573

Source: Housing Authority

^a Based on proposed budget

Public Housing

Beginning in the 1990s, HUD implemented programs to redevelop public housing by allowing private housing providers to redevelop and operate public housing. The Housing Authority converted or will convert all of its public housing units to privately-operated developments through programs or approval processes authorized by HUD:

- HOPE VI
- HOPE SF¹
- Section 18 Disposition
- Rental Assistance Demonstration (RAD)

Exhibit 2: Housing Authority Public Housing Disposition

Program	Number of Units
HOPE VI	1,149
HOPE SF ^a	1,917
Scattered Sites ^b	70
Rental Assistance Demonstration	3,480
Total Public Housing Units	6,616

Source: Housing Authority Annual Plan 2019

^a Four HOPE SF sites were approved by HUD for Section 18 Disposition: Alice Griffith, Hunters View, Potrero Terrace/Annex and Sunnydale.

^b The Housing Authority is disposing of five sites consisting of 70 units through the Section 18 disposition program; the housing sites will be developed and operated by non-profit housing providers, using project based vouchers (discussed below).

HOPE VI

Between 1993 and 1997, HUD funded the redevelopment of six San Francisco Housing Authority projects through HOPE VI. Private housing providers redeveloped and operated the 1,149 public housing units on the six sites, including two Hayes Valley sites, shown in Exhibit 3 below. The Housing Authority formed limited partnerships with four of the housing providers for Bernal Dwellings, Hayes Valley North and South, and Plaza East, in which the limited partnerships entered into long-term ground leases for the sites; and entered into long-term leases with the non-profit housing providers for North Beach and Valencia Gardens.

¹ HOPE SF is a local program utilizing HUD's Section 18 disposition program (discussed below).

Exhibit 3: HOPE VI Projects

Housing Site	Total Units	Non-profit Housing Provider
Bernal Dwellings	160	Bernal Housing Associates LP
Hayes Valley North and South	195	Hayes Valley Apartments LP(North) Hayes Valley Apartments II LP (South)
Plaza East	193	Plaza East Associates LP
North Beach	341	North Beach Housing Associates
Valencia Gardens	260	Valencia Gardens Housing LP
Total	1,149	

Source: Housing Authority Website

HOPE SF

The Housing Authority in collaboration with the City began HOPE SF in 2005, in which four public housing sites will be redeveloped through mixed use residential development. HOPE SF will redevelop 1,917 public housing units and create approximately 5,260 total units, shown in Exhibit 4 below. The projects consist of infrastructure development, public housing replacement, other affordable housing development, and market rate housing. For-profit developers are constructing the market rate housing, and non-profit developers are constructing the replacement public housing and other affordable housing. Once completed, the public housing and affordable housing will be operated by non-profit housing providers, who will enter into long-term ground leases with the Housing Authority for use of the sites.

Hunters View and Alice Griffith are the first of the four HOPE SF multi-phase developments. Hunters View will construct 750 affordable and market rate housing units, of which 267 are replacement public housing units. The first two phases of the Hunters View redevelopment are complete; the third phase is in progress. Alice Griffith will construct 1,210 affordable and market rate housing units, of which 256 are replacement public housing units. The first three phases of the Alice Griffith redevelopment were completed in 2017, and the fourth phase was completed in 2018.

Potrero Terrace/Annex and Sunnydale are in earlier stages of redevelopment. Potrero Terrace/Annex will construct approximately 1,600 affordable and market rate housing units, of which 619 are

replacement public housing units. Sunnydale will construct approximately 1,700 affordable and market rate housing units, of which 775 are replacement public housing units.

Exhibit 4: HOPE SF Projects

HOPE SF Project	Public Housing	Total Housing Units
	Replacement Units	
Hunters View	267	750
Alice Griffith	256	1,210
Potrero Terrace and Annex	619	1,600
Sunnydale	775	1,700
Total HOPE SF	1,917	5,260

Source: Housing Authority Annual Plan 2019

Section 18 Disposition and Rental Assistance Demonstration

HUD implemented two programs that allow housing authorities to use federal funds to leverage other financing to redevelop public housing. HUD's Section 18 Disposition program allows conversion of housing authority sites to mixed-finance developments in order to leverage federal funds with other financing sources.² The Rental Assistance Demonstration program (RAD) allows public housing units to be converted to project based vouchers³, which become a source of operating funds to repay debt incurred for rehabilitation of public housing by private developers.

Section 18 Disposition

HUD approved the demolition of Potrero Terrace/Annex and Sunnydale as part of Section 18 Disposition in 2017. In order to expedite the rehabilitation of these two projects, the Housing Authority is in negotiations with HUD to renovate and transfer the properties to non-profit ownership as part of the outsourcing of public housing operations and transition to redevelopment. Potrero Terrace/Annex and

² The Section 18 Disposition process allows housing authorities to qualify for awards of replacement tenant protection vouchers, which can be used for project-based vouchers.

³ Project based vouchers are Housing Choice Vouchers (Section 8) that are assigned to a housing unit rather than a tenant. Under RAD, the housing authority enters into renewable 15 to 20 year contracts for project based vouchers for housing units; the project based vouchers are a source of funds to repay debt incurred for rehabilitation/renovation of the housing units.

Sunnydale would be redeveloped in phases according to the approved development agreements.

Rental Assistance Demonstration

The Housing Authority plans to convert five small housing sites, totaling 70 housing units, to project-based vouchers, and transfer ownership and management to private housing providers under the Rental Assistance Demonstration (RAD) program.

The Housing Authority and City have converted 28 other public housing sites, totaling 3,480 housing units, to RAD and non-RAD project-based vouchers through the RAD and Section 18 Disposition initiatives. These 28 projects used private debt and equity generated by the federal low-income housing tax credit program and MOHCD loans to finance the rehabilitation of the projects. The 28 projects were developed and are operated by affordable housing providers.

The Housing Authority will also convert the HOPE VI and Hunters View/Alice Griffith HOPE SF sites to project-based vouchers through the RAD program.

Moderate Rehabilitation Program

The Moderate Rehabilitation Program allocates project based vouchers to privately-owned units that are rehabilitated. HUD discontinued the program in 1991; Housing Assistance Payment contracts in place prior to 1991 have been annually renewed since 1991. In 2017, the RAD program began allowing these projects to convert to project based vouchers; 18 of 23 Moderate Rehabilitation Program projects in San Francisco have been converted to RAD.

Asset Management

In 2017, the Housing Authority entered into a contract with TCAM to provide asset management services to the HOPE VI, HOPE SF sites, and the 28 housing projects converted through the RAD program, noted above. Under this contract, TCAM monitors housing affordability and tracks required debt service and ground lease payments.

Shortfall in Housing Choice Voucher Program

The Housing Authority manages two types of housing vouchers:

- Project based vouchers, in which the voucher is assigned to a housing unit rather than a tenant
- Tenant based vouchers that allow tenants to obtain housing in the private market

In 2018, the Housing Authority administered 12,165 housing vouchers, which were a combination of project based and tenant based (including tenant protection⁴) vouchers. The monthly expenditures were \$22.5 million in December 2018. In the fall of 2018, the Housing Authority was discovered to have up to a \$30 million shortfall in the housing voucher program, which included \$10 million eligible for HUD shortfall funding. To close the shortfall, the City provided a forgivable loan of up to \$20 million from the Housing Trust Fund, and HUD committed \$10 million and authorized the Housing Authority to use \$5 million from reserves. The Housing Authority spent \$10.3 million of the City loan to cover the CY 2018 shortfall. HUD has since provided the Housing Authority with \$6.2 million to reimburse City loan funds that had been spent on the CY 2018 shortfall.

The shortfall of up to \$30 million resulted from escalating rents in San Francisco, an increase in the number of Housing Choice Vouchers, and inadequate financial reporting and projections. The Housing Authority terminated the Authority's finance director and budget analyst, and entered into a contract with an accounting firm, BDO, to assess the financial condition and prepare financial projections.

HUD's Quality Assurance Division reviewed the financial status of the Housing Choice Voucher program, and developed corrective actions to be taken by the Housing Authority.

Preliminary Terms for the City's Assumption of the Housing Authority's Essential Functions

In March 2019, HUD determined that the Housing Authority was in substantial default under the Housing Choice Voucher and public housing programs. According to HUD's March 2019 default notice, HUD has the authority to place the Housing Authority in receivership, taking possession of all or part of the Housing Authority. HUD agreed, as an alternative to receivership, that the Housing Authority could remedy

⁴ Tenant-protection vouchers are designed to protect tenants when public housing is sold or converted. As noted above, tenant-protection vouchers can be converted to project-based vouchers.

the default through the City's assumption of the Housing Authority's essential functions. As part of the City's assumption of the Housing Authority's essential function, the Housing Choice Voucher program and public housing program were to be contracted to third parties.

The City submitted a draft Memorandum of Understanding (MOU) to HUD in April 2019, outlining the preliminary terms of the City's assumption of Housing Authority functions as shown below:

Labor Relations

The Housing Authority was to give notice to existing Housing Authority employees on the reduction in Housing Authority staffing, resulting from the City's assumption of and contracting out of Housing Authority functions, as required by HUD. The Housing Authority has been developing severance packages for employees who will be impacted and is partnering with the City to assist with finding City jobs for these employees when possible. The Mayor sent a letter to Housing Authority employees and the respective labor units in April 2019, discussing the contracting out of Housing Authority functions, and stating the City's commitment to minimize the impact on employees.

Restructuring of the Housing Authority

The MOU provided a preliminary restructuring plan that included:

- Appointment of City staff to provided executive management oversight of Housing Authority functions;
- Plan to contract out the Housing Authority's public housing and Housing Choice Voucher programs; and
- Development of a specific timeline to integrate the Housing Authority's systems, processes, and the policies with the City for financial oversight, information technology, human resources, real estate, purchasing, and legal oversight.

The April 2019 draft MOU further provided for the parties (HUD, Housing Authority, City) to commit to the capital funding necessary to redevelop the public housing under HOPE SF; and to continue to convert the public housing units to project based vouchers.

Shortfall Funding

HUD maintains a fund to annually augment local housing authorities' budgets that have a shortfall in their housing voucher programs. HUD

provided \$10 million in shortfall funding to the Housing Authority in 2018. According to the April 2019 draft MOU, the Housing Authority will apply for HUD's shortfall funding annually, or as frequently as needed. The Housing Authority applied for CY 2019 shortfall funding in February 2019, and HUD has indicated that it expects to be able to cover the housing voucher shortfall projected for 2019.

Draft Memorandum of Understanding Submitted to the Board of Supervisors for Approval

A resolution was introduced to the Board of Supervisors on July 9, 2019 to approve the MOU between the City and the Housing Authority setting the terms by which the City will assume responsibility and oversight of the Housing Authority. According to the proposed MOU:

Executive Management and Shared Services

- The City will provide executive management staff to the Housing Authority, including a chief executive officer reporting to the Mayor or the Mayor's designee.
- The Housing Authority will integrate with City services over time, including information technology, human resources, purchasing, real estate, financial systems, and other services. The timing and process of integration will be developed in consultation with MOHCD, Controller, and General Services Agency.

Administration and Oversight

- The annual Housing Authority budget will be submitted to the Mayor and the Board of Supervisors, who may accept or reject the budget. The budget submission will be consistent with City procedures and HUD timelines and requirements.
- Administration of the Housing Choice Voucher program and public housing will be contracted to third parties, as required by HUD and discussed above. The Housing Authority will work with the City to procure third-party contractors, but the contracting process must conform to HUD requirements. Contracts for property transactions will be subject to third-party appraisal with the exception of properties conveyed for development of affordable housing.
- Financial management of the Housing Authority will be contracted to a third party with expertise and experience in HUD financial

reporting and requirements. Currently, the Housing Authority contracts with BDO USA LLP for financial management and reporting.

- Issuance of debt by the Housing Authority must be approved by the Authority and the Board of Supervisors.
- Any material amendment to the MOU are subject to prior approval by the Board of Supervisors.

Housing Authority Commission

- The Housing Authority Commission is authorized by state law to have seven members, appointed by the Mayor, two of whom must be Housing Authority residents. Under the proposed MOU, the Mayor would appoint four members directly, and three members recommended by motion at the sole discretion of the Board of Supervisors. Of the Mayor's four appointments, at least one must be a Housing Authority resident. Of the Board's three appointments, at least one must be a Housing Authority resident 62 years of age or older.

Non-Housing Assets

- The Housing Authority will (a) inventory non-housing assets, including the building at 1815 Egbert Street, vehicles, and other assets; (b) identify which assets are needed for ongoing operations;; and (c) plan disposition of surplus assets in accordance with HUD requirements Loans made by the City to the Housing Authority will be repaid from surplus funds from the disposition of assets, subject to HUD requirements.

The provisions in the preliminary MOU in April 2019 for addressing the (a) impact to existing Housing Authority employees from the transfer of essential functions to the City, and (b) potential shortfall in the Housing Choice Voucher program are included in the proposed MOU.

1 Housing Voucher Program

The City is currently negotiating with the federal Department of Housing and Urban Development (HUD) to assume the essential functions of the San Francisco Housing Authority, including the oversight of public housing and housing subsidies to tenants renting in the private market. Housing operated by private affordable housing providers and private market rentals are funded by the housing voucher program through project-based vouchers for affordable housing and tenant-based vouchers for private market housing. HUD has allocated more than 17,000 vouchers to San Francisco through 2031.

Annual housing voucher program funding allocations to the Housing Authority are based on prior year expenditures with inflation adjustments, which results in structural funding deficits if the inflation adjustments are too low. HUD sets aside funds each year to cover anticipated deficits, which are awarded on a first-come, first-serve basis.

San Francisco is at risk to have insufficient HUD funding in the future to pay all housing voucher program costs. BDO, which is currently serving as the Housing Authority's financial accounting and reporting entity, estimates that the average funding shortfall could range from \$16.2 million to \$18.4 million per year between CY 2019 and CY 2031. According to the Mayor's Office of Housing and Community Development (MOHCD), HUD has indicated that it can cover the housing voucher program shortfall in 2019. The funding shortfall in future years could be partially offset by supplemental funding from HUD, but the Housing Authority would need to apply in sufficient time each year to be eligible for supplemental funding.

San Francisco is at risk to have insufficient HUD funding in the future to pay all housing voucher program costs

Housing Voucher Program

The majority of federal Department of Housing and Urban Development (HUD) funding to support access to affordable rental housing by low and very low income households in San Francisco is provided through the housing voucher program. The housing voucher

program may in turn be divided into two broad sub-categories, namely whether the voucher is designated as a tenant- or project-based voucher. *Tenant-based vouchers* (also called “Housing Choice Vouchers”) allow qualifying households to obtain a voucher that can be used to pay for rental housing in the private market. *Project-based vouchers* are a form of rental assistance in which the voucher is assigned to a given unit in a HUD supported low income housing development.

HUD regulations allow a local housing authority to “project base” up to 20 percent of the total number of authorized housing vouchers.⁵ In addition, HUD may authorize an allocation of tenant-protection vouchers to a local housing authority. Tenant-protection vouchers are awarded to replace public housing being demolished or disposed of, including to provide rental payment subsidies to tenants who are relocated when their housing project undergoes conversion and redevelopment. These vouchers can be project-based on a former public housing site without counting against the 20 percent cap on the total housing voucher allocation. Tenant-protection vouchers are currently the largest single source of project-based vouchers being used to support the redevelopment of almost all of San Francisco's public housing.

Exhibit 5 below shows the total number of housing vouchers broken down by category that were authorized by HUD to the San Francisco Housing Authority for Calendar Year (CY) 2016, 2017 and 2018. Exhibit 5 also shows the Housing Assistance Payment for all housing vouchers for December in the given calendar year. The total number of housing vouchers allocated to the Housing Authority in 2018 was 12,165. Of the total allocation for CY 2018, 6,215, or 51 percent, were tenant-based vouchers, and 5,950, or 49 percent, were designated as project-based. Tenant-based vouchers accounted for 57.2 percent of the total Housing Assistance Payment, while project-based vouchers accounted for 42.8 percent.

⁵ Housing for formerly homeless households and former public housing sites may exceed the 20 percent cap.

Exhibit 5: Housing Vouchers, 2016 through 2018, by Category ⁶

Voucher Category	2016		2017		2018	
	Units	Housing Assistance Payment December	Units	Housing Assistance Payment December	Units	Housing Assistance Payment December
Tenant Based						
Basic	5,377	\$7,886,209	5,422	\$9,960,184	5,523	\$11,474,391
VASH ^a	470	605,482	554	964,928	593	1,129,870
Family Unification	74	132,115	71	170,081	99	267,393
Subtotal Tenant Based	5,921	\$8,623,806	6047	\$11,095,192	6215	\$12,871,655
Project Based						
Moderate Rehabilitation		\$0	125	\$231,276	585	\$1,085,661
Project Based	1,191	1,741,793	1,248	2,355,878	1,303	2,803,149
LOSP ^b		0	400	781,407	439	846,818
RAD Sites ^c	1,626	1,179,570	1,987	1,388,483	2,057	1,471,531
Other RAD Sites ^d	343	491,661	857	1,642,488	1,294	3,069,395
VASH PBV	212	199,119	271	285,203	272	371,021
Subtotal Project Based	3,372	\$3,612,143	4888	\$6,684,735	5950	\$9,647,575
Total	9,293	\$12,235,949	10,935	\$17,779,928	12,165	\$22,519,230

Source: Housing Authority

^a Veterans Affairs Supportive Housing (VASH)

^b Local Operating Subsidy Program (LOSP)

^c Rental Assistance Demonstration (RAD)

^d Other project based vouchers at RAD sites

As seen in Exhibit 6 below, the total number of all housing vouchers (tenant and project-based) increased by 31 percent between CY 2016 and 2018. The total December Housing Assistance Payment to the Housing Authority increased by 84 percent, and average per voucher payment increased by 41 percent over the three year period.

⁶December has the highest monthly Housing Assistance Payment for the year, and establishes the beginning payment for the following calendar year.

Exhibit 6: Total Housing Vouchers, December Housing Assistance Payment, and Average Voucher Payment CY 2016 to 2018

	Total Housing Vouchers	December Assistance Payment	Average Payment per Voucher
CY 2016	9,293	\$12,235,949	\$1,317
CY 2017	10,935	\$17,779,928	\$1,626
CY 2018	12,165	\$22,519,230	\$1,851
3 Year Increase	2,872	\$10,283,281	\$534
Percent Increase	31%	84%	41%

Source: BDO

Exhibit 7 below shows the factors contributing to the 84 percent increase in the December monthly Housing Assistance Payments to the Housing Authority between CY 2016 and CY 2018. Of the increase of \$10,283,281, 30.9 percent is attributed to the increase in the number of vouchers, 40.6 percent is attributed to the increase in the voucher amount, and 12.5 percent is attributed to interaction of the increase in the number of voucher and the monthly voucher amount.

Exhibit 7: Factors Contributing to Increase in December Housing Assistance Payment to the Housing Authority 2016 to 2018

	Dollar Amount	% Change, Total and by Factor
Increase in voucher amount	\$4,966,780	40.6%
Increase in number of vouchers	3,781,518	30.9%
Interaction (number and amount) ⁷	1,534,983	12.5%
Total increase 2016-2018	\$10,283,281	84.0%

Source: BDO

The increase in the payment amount per voucher is the main factor driving the total increase in the Housing Assistance Payment to the Housing Authority in the month of December. This reflects the method used by HUD to calculate the per voucher payment amount. The Housing Assistance Payment is based on the difference between the “fair market rent”, set at the 40th percentile of the current rental market, and 30 percent of the household income of the voucher holder or the unit occupant, adjusted for allowable deductions. Local housing authorities may adjust the fair market rent by a factor ranging for 0.9 to 1.1. The higher adjustment factor is currently utilized in San Francisco,

⁷ The interaction factor is based on a standard statistical formula.

so that the fair market rent is based on the 44th percentile of current market rents. The rental assistance payment allows low and very low income households to acquire housing units on the open rental market if they can find landlords willing to rent at the 44th percentile. Tenant-based vouchers, but not project-based vouchers, are portable, and provided that households continue to meet the eligibility requirements, can be used anywhere that a tenant-based voucher program is administered.

The fair market rent is linked to the cost of renting housing units on the private market, and is thus subject to cost increases due to the overall condition in the San Francisco housing market. Even though the Housing Authority and MOHCD are not anticipating any future increase in the total number of HUD authorized vouchers other than for tenant protection vouchers, the cost of each tenant-based voucher will likely increase as market rents in San Francisco increase.

HOPE SF and the Rental Assistance Demonstration Program

San Francisco has entered into discussions with HUD to dispose of the Housing Authority's remaining public housing stock, with the sole exception of the HOPE VI North Beach project. The four HOPE SF sites – Hunters View, Alice Griffith, Potrero Terrace and Annex, and Sunnydale – were previously approved by HUD to be converted to private ownership. Housing assets will be transferred primarily to non-profit housing developers, who will assume responsibility for site redevelopment, as well as ongoing maintenance and project management. These four sites are being redeveloped as replacement public, other affordable, and market rate housing. Twenty-eight other public housing sites have been converted to non-profit ownership as part the Rental Assistance Demonstration (RAD) and non-RAD project-based voucher initiative that was approved by HUD in 2014. In addition 70 scattered sites will be transferred to a private non-profit developer.

HUD authorized 4,406 tenant protection vouchers to provide ongoing rent subsidies for HOPE SF and RAD tenants as part of the redevelopment of these sites. As noted above, these vouchers generally do not count against the 20 percent project-based cap, and are currently the largest category of vouchers that will fund redevelopment of both HOPE SF and the other public housing units

converted through RAD. Exhibit 8 shows the major categories of housing vouchers authorized (though not finally committed) by HUD through 2031. Of the total 17,125 housing vouchers allocated by HUD through 2031, 5,848 are tenant-based vouchers allowing eligible households to seek housing on the private rental market, and 10,687 are project based, supporting the long-term operation of the former public housing units that have been converted to non-profit ownership.

Exhibit 8: Housing Vouchers by Category

Category	Number of Vouchers
<i>Project-Based, by sub-category</i>	
Tenant Protection	4,406
Rental Assistance Demonstration 1	2,612
Rental Assistance Demonstration 2	1,052
Project Based	1,991
Veterans Assistance Supportive Housing	448
HOPE VI (Annual Budget Authority)	178
Total, Project Based	10,687
Tenant Based Vouchers	5,848
Veterans Assistance Supportive Housing	590
Total Allocation through 2031	17,125

Source: BDO

The total allocation of project-based vouchers to Hope VI is 935 and to HOPE SF are 3,060, as shown in Exhibit 9 below.

Exhibit 9: Project-Based Funding of HOPE VI and HOPE SF

Type of Voucher	HOPE VI	HOPE SF
Rental Assistance Program	368	377
Tenant Protection Vouchers	69	2,683
Project-Based Vouchers	320	0
Annual Budget Authority	178	0
Total	935	3,060

Source: BDO

Housing Assistance Payment Funding and Supplemental Appropriations

The total Housing Assistance Payment authorized by HUD at the beginning of the calendar year is determined by the average monthly expenditure from the *prior* calendar year. HUD will typically include an adjustment for inflation, which was around 1 percent for 2018, and can

make additional adjustments in the amount of the voucher payment based on changes in the fair market rent. In addition, HUD has specific provisions affecting the total funding of various categories of vouchers that can modify the actual total Housing Assistance Payment.

Because the amount authorized at the beginning of the calendar year is based on the prior year and HUD's methodology for inflation adjustments does not fully address markets with continuously rising rents, this amount will almost always understate the actual cost of housing payments in an environment such as San Francisco characterized by rising rental housing costs. Housing authorities typically enter each year with a structural funding deficit. To address this funding gap, HUD sets aside funds each year to cover anticipated deficits in local housing authorities rental housing assistance payments. However, the total federal supplemental set-aside is not sufficient to cover all housing authorities' supplemental funding requests. Funds are awarded on a "first come, first serve" basis, although HUD has some discretion to determine the priority of the supplemental funding allocation. If the local housing authority does not submit request on time, funds may be depleted by the time the funding request is actually submitted.

➤ **The Housing Authority could have future shortfalls in the Housing Voucher Program ranging from \$16.2 million to \$18.4 million**

San Francisco is at risk to have insufficient HUD funding in the future to pay all housing voucher program costs. BDO, which is currently serving as the Housing Authority's financial accounting and reporting entity, has constructed estimates of various future funding shortfall scenarios shown in Exhibit 10. Under these scenarios, the average annual funding shortfall could range from \$16.2 million⁸ to \$18.4 million⁹ between CY 2019 and CY 2031. The funding shortfall could be partially offset by supplemental funding from HUD, but the Housing Authority would need to apply in sufficient time each year to be eligible for supplemental funding.¹⁰

⁸ Based on an annual increase in the Housing Assistance Payment to SFHA of 2.5 percent

⁹ Based on an annual increase in the Housing Assistance Payment to SFHA of 1.6 percent

¹⁰ Also, as discussed below, even if the Housing Authority and MOHCD are in full compliance with all HUD requirements regarding submission for supplemental shortfall appropriations, HUD is not under legal

Exhibit 10: Estimated Range of Potential Future Funding Shortfalls

Estimated Shortfall Based on Percent Increase in Annual HUD Housing Assistance Payment		
Year	2.50%	1.60%
2019	\$18,752,927	\$20,560,737
2020	11,970,655	23,352,228
2021	12,653,260	25,395,712
2022	15,991,211	17,705,731
2023	13,319,020	13,387,712
2024	17,039,069	18,109,669
2025	15,135,843	15,135,843
2026	13,276,479	13,276,479
2027	17,681,391	17,681,391
2028	18,587,900	18,587,900
2029	20,469,376	20,469,376
2030	19,036,564	19,036,564
2031	16,865,673	16,865,673
Average per Year	\$16,213,798	\$18,425,309
Cumulative	\$210,779,370	\$239,529,015

Source: BDO

Tenant-Based Vouchers Risks

The City has the option to negotiate the use of payments to non-profit housing providers, operating former public housing units funded by project-based vouchers to offset funding shortfalls, but has limited options to negotiate with private property owners to offset shortfalls in tenant-based vouchers. The City could potentially incur future costs for the 6,438 tenant-based and Veterans Assistance Supportive Housing vouchers allocated by HUD through 2031

HUD Funding and Project-Based Vouchers

Whether HUD funding for project-based vouchers in the future will be sufficient to cover obligations is not known. Redevelopment of housing

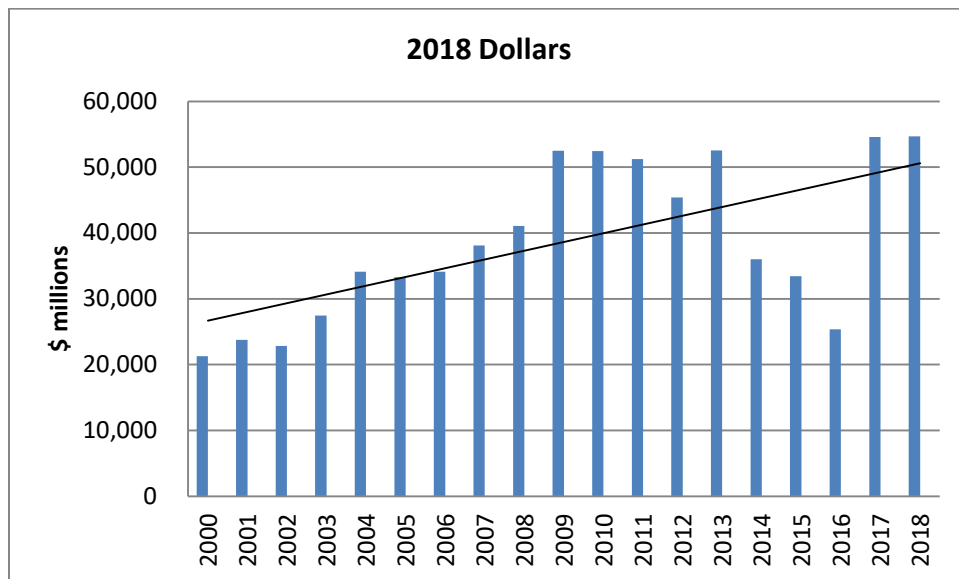
obligation to cover these shortfalls if HUD has exhausted the amount of the prior year Congressional appropriations for shortfall funding. Also, HUD's practice of initially under-funding tenant protection vouchers, pending appeal by the housing authority and submission of actual costs, increases the risk of funding shortfalls. While the City is not obligated to make up the shortfall, the City provided a loan to the Housing Authority to partially offset the shortfall in the housing voucher program in 2018.

sites and property transfers undertaken as part of the RAD conversions have been financed, in part, through long-term loans issued by private lenders. Loans have been issued based upon the assumption that HUD will continue to honor its commitments to support the project-based voucher payments. Cuts in future housing voucher appropriations could impair the ability of nonprofit and other private managers of public housing to operate these properties if the housing authority does not have enough voucher program funds to allocate the required amounts to these projects, and consequently could lead to defaults on the long-term debt obligations to finance redevelopment and transfer of the public housing to nonprofit and other managers. Because private property managers/owners and banks or other lending institutions could be harmed if HUD funding were insufficient to cover obligations, future reductions in housing voucher appropriations may be limited.

Federal Appropriations to HUD

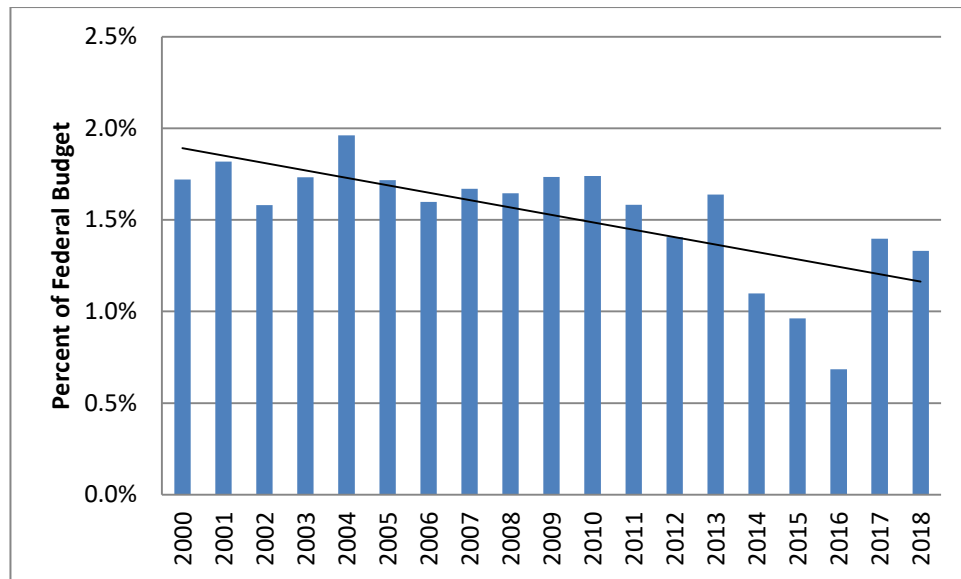
The annual federal appropriation to HUD varied during the 18-year period between 2000 and 2018 but increased overall from \$20 billion (2018 dollars) in 2000 to \$54.7 billion in 2018.

Exhibit 11: Annual Appropriation to HUD 2000 to 2018



Source: Office of Management and Budget

However, the annual federal appropriation to HUD as a percent of the total federal appropriation reduced from 1.7 percent in 2000 to 1.3 percent in 2018 (a reduction of more than 25 percent), as shown in Exhibit 12 below.

Exhibit 12: HUD Budget as Percent of Federal Budget 2000 to 2018

Source: Office of Management and Budget

Because total HUD funding, including funding for housing vouchers, is subject to the annual federal appropriation, future economic recessions or federal policy changes could reduce Housing Assistance Payments to the Housing Authority. According to the Congressional Research Service, the cost of renewing Housing Choice Vouchers (tenant-based vouchers) is one of the most contentious HUD funding issues each year. Funding for tenant-based vouchers for households currently receiving vouchers requires annual renewal, but the amount of funding needed to renew tenant-based vouchers is difficult to estimate due to changes in market rents and tenant outcomes, which could result in insufficient funding.

In order to account for the impact to the Housing Trust Fund or the City's General Fund in the event that the City were to backfill potential reductions in future Housing Assistance Payments to the Housing Authority, the Board of Supervisors should request the Mayor, Controller, and Budget and Legislative Analyst to consider such potential reductions in the City's five-year financial projections.

Moreover, even if the Housing Authority and MOHCD are in full compliance with all HUD requirements regarding submission for supplemental shortfall appropriations, HUD is not under legal obligation to cover these shortfalls if HUD has exhausted the amount of the prior year Congressional appropriations for shortfall funding. The Housing

Authority and MOHCD should report annually to the Board of Supervisors on their application for supplemental shortfall funding, and availability of supplemental HUD funding to cover the Housing Authority shortfalls.

Conclusion

The City faces financial risks from potential shortfalls in HUD funding the housing voucher program. The City and the Housing Authority will need to ensure accurate financial reporting and timely application for supplemental funds each year to fill funding shortfalls. MOHCD and the Housing Authority should report at least once per year to the Board of Supervisors after the December close on the level of funding of the housing voucher program. In addition, MOHCD should notify the Board regarding the emergence of a funding shortfall that will require supplement appropriation immediately after the cause and amount of these shortfalls become known.

Recommendations

The Board of Supervisors should:

Recommendation 1: Request MOHCD and the Housing Authority to report at least once per year to the Board of Supervisors after the December close on the level of funding of the housing voucher program. This report should include information on (1) current utilization, (2) funding levels and year-to-date funding shortfalls, (3) changes in fair market rents, (4) details on the financial conditions of both project-based and tenant-based vouchers, and (5) status of the application for and availability of supplemental shortfall funding to cover the Housing Authority shortfalls.

Recommendation 2: Request the Mayor, Controller, and Budget and Legislative Analyst, when preparing the City's five-year financial projections, to consider potential reductions in Housing Assistance Payments to the Housing Authority and potential impact to the Housing Trust Fund or City General Fund if the City were to backfill reductions in federal funding.

The Housing Authority Executive Director and MOHCD Director should:

Recommendation 3: Notify the Board of Supervisors regarding the emergence of a funding shortfall that will require supplemental funding from HUD and/or a supplemental appropriation from the City immediately after the cause and amount of these shortfalls become known.

2 Governance

As the City moves forward to assume responsibility for essential Housing Authority functions, and because of the increased financial risk assumed by the City and potential impact to San Francisco residents, the City should negotiate with HUD on the Housing Authority's accountability under the City Charter and Administrative Code. Charter and Code provisions requiring Board of Supervisors approval of the annual budget and of contracts and leases above a certain threshold should be part of the discussions with HUD. In addition, the City should negotiate with HUD to include in the proposed Memorandum of Understanding (MOU) between the City and the Housing Authority that all property transactions be submitted to the Board of Supervisors to confirm conformance with the terms of the respective development agreements. While this provision would not change any of HUD's authority in disposing of Housing Authority property, it would ensure that Housing Authority property is sold to private parties through an open and competitive process and in conformance with the development agreements.

The Board of Supervisors should also codify the Board's preferred structure for the Housing Authority's Board of Commissioners by amending Section 12.2 of the Administrative Code.

The City should ensure in negotiations with HUD that the City has adequate oversight of Housing Authority operations

In accordance with California State law, which requires public housing authorities to be governed by a commission, the Board of Commissioners ("Commission") will continue to have governing authority of the Housing Authority. The Commission consists of seven members, appointed by the Mayor, who establish the Housing Authority business policies and ensure that Housing Authority staff properly implement these policies (two of these members must be the Housing Authority tenants). The Commissioners are responsible for "preserving and expanding the agency's resources and assuring the agency's continued viability

and success.” The Board of Commissioners also selects and hires the Housing Authority Executive Director.

Currently, the Commission authorizes expenditures over \$30,000, approves the agency’s annual Public Housing Agency (PHA) Plan prior to HUD submission, and meets monthly to hear the Commission’s committee updates and other matters. The Commission has one active committee—Development, Finance and Operations—that oversees: (1) expenditures over \$30,000, and (2) program & operations updates for the following areas:

- Housing Choice Vouchers SEMAP Indicators¹¹
- Special Leased Housing Programs
- Personnel
- Governance and Policy
- Finance
- HOPE SF, Scattered Sites, HOPE VI
- Procurement
- Information Technology

Another critical function that the Commission provides is resident participation, through membership and public comment, and acts as the final arbiter with regard to resident complaints.

The proposed Memorandum of Understanding (MOU), submitted to the Board of Supervisors for approval on July 9, 2019, proposes a seven-member Commission consisting of four members appointed by the Mayor directly and three members recommended for appointment by motion of the Board of Supervisors. Of the City’s 19 commissions, five commissions have four Mayoral appointments and three Board of Supervisors appointments – Building Inspection, Planning, Police, Entertainment, and Small Business.¹² The Board has authority to approve all seven appointments for three of these five commissions – Planning, Police, and Entertainment.

¹¹ SEMAP, or the Section 8 Management Assessment Program, measures the performance of the housing authority administering the Housing Choice Voucher program based on 14 indicators.

¹² The 19 commissions include 18 commissions authorized in the Charter and one commission – Community Investment and Infrastructure – authorized by ordinance. Appointments to ten commissions are made by the Mayor without Board of Supervisors approval; appointments to three commissions are made by the Mayor and approved by the Board; and appointments to the Youth Commission are made jointly by the Mayor and Board, with the Mayor having six appointments and the Board having 11 appointments.

Because authority to appoint or approve appointment of commission members varies among the 19 City commissions, no specific criteria exist for Board of Supervisors appointment or approval of appointment of commission members. In approving the proposed MOU, the Board of Supervisors has the option to (a) accept the proposed Housing Authority Commission structure, or (c) select some other commission appointment structure. The Board of Supervisors should codify the accepted commission structure by amending Section 12.2 of the Administrative Code.

➤ **Effectively a City function, the City should negotiate with HUD on the Housing Authority's accountability to the Board of Supervisors under the City Charter and Administrative Code**

According to the April 2019 Draft MOU, Section 1.2 Restructuring Plan, "The [City and the Housing Authority] will develop a plan to restructure the Authority that provides the City with oversight" in compliance with HUD's March 2019 Default Letter, based on the following: (a) executive management; (b) essential functions; and (c) shared services. However, the oversight as detailed in the draft MOU does not adequately provide for the appropriate oversight by the Board of Supervisors.

The April 2019 Draft MOU refers to the oversight function of the Board of Supervisors primarily with regard to executing the transfer of functions and restructuring. For example, in Section 1.3 Approvals, the draft MOU states: "Having secured the approval of this MOU under the Board of Supervisors resolution referenced at the end of the signature block below, City staff will continue to **conduct outreach to the Board of Supervisors regarding the restructuring of the Authority and the assumption of responsibilities**. After the completion of the Authority's obligations to meet-and-confer with representative labor organizations, the City will obtain the prior approval by the Board of Supervisors of any additional agreements as required by the San Francisco City Charter Section 9.118 or any other applicable Charter section or City ordinance." [emphasis added]

According to the proposed MOU submitted to the Board of Supervisors on July 9, 2019, "the City will assume responsibility and

oversight of the Authority, including Essential Functions”. As noted in the Introduction to this report, Board of Supervisors oversight will include:

- Acceptance or rejection of the annual budget;
- Issuance of debt;
- Material changes to the MOU; and
- Appointment of three Housing Authority Commission members.

Both because of the increased financial risk assumed by the City and because of the potential impact to San Francisco residents, the Board of Supervisors oversight of the Housing Authority’s functions should be included in negotiations with HUD.

The “essential” functions that the City has agreed to assume include financial management, program management, waitlist and admissions, inspections, eligibility determinations, and lease and grievance procedures. HUD required that the MOU include “plans for outsourcing financial and programmatic services for the HCV¹³ and LRP¹⁴ programs to third party experts”. As discussed in Section 1 of this report, the assumption of these functions carries ongoing financial risk to the City, which could include the City deciding to backfill shortfall funding.

Because the City will assume accountability for Housing Authority finances and operations, the Housing Authority will effectively function like a City department. Negotiations with HUD should include consideration of how standard reporting and governance procedures for City departments, as codified in the City Charter and Administrative Code, would apply to the Housing Authority. This would include:

- Participation in the City’s annual budget process, as defined in San Francisco City Charter Article IX Financial Provisions and the Administrative Code Chapter 3 (“Budget Process Ordinance”), including the review and adoption of appropriation ordinances by the Board of Supervisors, and in accordance with the distinctions of capital improvements and facilities maintenance as provided.

¹³ Housing Choice Voucher

¹⁴ Low Rent Public Housing

- Contract approvals by the Board of Supervisors, as outlined in the City Charter Article IX Section 9.118, for contracts having a term in excess of ten years or requiring expenditures of ten million dollars.
- Lease approvals by the Board of Supervisors, as outlined in City Charter Article IX Section 9.118, for lease terms of ten or more years.

In addition, the City should negotiate with HUD to include in the proposed MOU between the City and the Housing Authority that all property transactions be submitted to the Board of Supervisors to confirm conformance with the terms of the respective development agreements. While this provision would not change any of HUD's authority in disposing of Housing Authority property, it would ensure that Housing Authority property is sold to private parties through an open and competitive process and in conformance with the development agreements.

Conclusion

As described in Section 1 of this report, the City will take on potentially significant financial risk as it assumes responsibility for the Housing Authority's essential functions. Even as it outsources program management to third party vendors, the Housing Authority will effectively operate like a City agency. The City should negotiate with HUD to ensure that oversight of that the Housing Authority's budget and financial activities fall under the Charter and Administrative Code provisions that govern other City departments.

Recommendations

The Board of Supervisors should:

Recommendation 4: Request the Mayor and the Acting Executive Director of the Housing Authority to negotiate with HUD on the Housing Authority's accountability to the Board of Supervisors in conformance to the City Charter and Administrative Code, including annual budget review consistent with HUD requirements, contract and lease approvals above relevant thresholds, and property transactions to confirm conformance with the terms of the respective development agreements.

Recommendation 5: Adopt an ordinance to amend Chapter 12, Section 12.2 of the Administrative Code to codify the Housing Authority Commission structure adopted by the Board.

3 Management

The proposed Memorandum of Understanding between the Housing Authority and the City provides for the restructuring of the Housing Authority, in which core functions will be contracted out and Housing Authority operations will be overseen by City staff serving as executive management, including an Executive Director reporting directly to the Mayor or her designee. The appointment of the Executive Director, whose role and accountability is essential to the City's oversight of the Housing Authority's functions, should be a priority.

Some Housing Authority positions will be retained, primarily to manage contract performance for financial and programmatic services. Because inadequate performance of these contracts will have significant impact on the Housing Authority's finances and programs, the new Executive Director must ensure that the staff who fill Housing Authority positions demonstrate the necessary competence for ongoing contract management of the Housing Authority programs.

In addition, following the expiration of the BDO contract, including any extensions, and restructuring of the Housing Authority, the City should directly hire qualified financial staff to perform those financial systems monitoring duties. This will be cost-efficient and will enhance the City's ability to monitor and ensure quality financial management and reporting of the Housing Authority activities. The Housing Authority should also transition to the City's financial system to allow the Controller direct access to financial information to ensure his ability to ensure quality and accuracy.

The appointment of an Executive Director to oversee and be accountable for the restructuring of the Housing Authority should be a priority, but the proposed MOU does not set a timeline for the appointment

According to the draft Memorandum of Understanding (MOU) between the Housing Authority and the City, dated April 8, 2019, the parties "will develop a plan to restructure the Authority that

provides the City with oversight and complies with Default Letter based on the following:

- (a) Executive Management: The City will appoint staff to perform executive managerial oversight of the Authority for all Essential Functions (“Executive Management”)

In its default letter dated March 8, 2019, HUD defined the essential functions as “all programmatic and financial functions of SFHA’s HCV¹⁵ and LRP¹⁶ Programs, including but not limited to financial management, program management, wait list and admissions, inspections, eligibility determinations, and lease and grievance procedures.”

- **The Mayor should prioritize the appointment of the Housing Authority Executive Director reporting to the Mayor or the Director of the Mayor’s Office of Housing and Community Development**

The proposed MOU submitted to the Board of Supervisors on July 9, 2019 provides for City staff to perform Executive Management, including an Executive Director reporting directly to the Mayor or her designee, subject to confirmation by the Commission. The role and accountability of the Executive Director is essential to the City’s oversight of the Housing Authority’s functions, which has a \$67 million annual operating budget for FY 2018-19, and serves over 18,000 San Francisco families.

The Mayor appointed a City staff person to lead the Transition Team as the City prepares to take over the functions of the Housing Authority. The Transition Team leader will be responsible to develop and implement the transition plan, including timelines, staffing needs, and budget requirements. The proposed MOU does not specify the time by which an Executive Director will be appointed following the transition of the Housing Authority to the City. The Board of Supervisors should affirm that the appointment of an Executive Director, accountable for the effective performance of the Housing Authority, is a priority.

¹⁵ Housing Choice Voucher

¹⁶ Low Rent Public Housing

➤ **The City needs to ensure the competency and effectiveness of the core the Housing Authority staff**

The City plans to retain core Housing Authority staff, who will primarily manage contracts for financial and programmatic services. Even after the full transition of essential functions to the City, the Housing Authority will need to continue to operate in a limited capacity in order to remain eligible for certain operating subsidies from HUD and to prevent the trigger of full withdrawal from CalPERS. (We discuss the Housing Authority's pension liability in more detail in Section 4 of this report.)

According to City officials, the core staff retained at the Housing Authority will include:

- Contract managers
- Accounting staff
- Commission support staff
- Resident outreach workers

Some or all of these staff may be recruited from within the Housing Authority's existing workforce.

The contract managers in particular will have significant responsibilities, given the scope of the services that are or will be contracted out: financial services, Housing Choice Voucher administration, Low Rent Public Housing administration, and asset management. The program management contracts have multiple components (from eligibility determinations to housing inspections to reporting), and there are great risks to the City (and the Housing Authority tenants) if these contractors fail to perform. The new Executive Director needs to ensure that the core staff retained at the Housing Authority during and after the transition demonstrate full competence to carry out these important duties, particularly with regard to contract management.

In addition, as discussed below, we recommend that the Housing Authority no longer contract out for financial services, following the completion of the restructuring process. Qualified financial supervisory staff should be hired by the City, and work-ordered to the Housing Authority, at the expiration of BDO's contract.

➤ **Financial services should be brought in-house at the expiration of the existing contract for financial services**

Once it assumes full responsibility for the Housing Authority's essential functions, and the transition to City oversight has been completed, the City should bring the financial services function in-house to save costs and ensure long-term operations. In August 2018, the Housing Authority entered into a contract with BDO PHA Finance, LLP (BDO) for the provision of finance operations consultant services including:

- Finance Department assessment and oversight
- Year-end close, reporting to HUD/Real Estate Assessment Center, and Accounting Services
- Independent public accountant coordination, evaluation and report
- Voucher Management System reporting and reconciliation
- Budget and operating subsidy process, including budget projections
- Develop/refine cost efficiencies and staffing ratios
- Monitor and manage the Housing Authority's unfunded pension and other liabilities
- Evaluate and make recommendations to improve the financial management/reporting software
- Coordinate HUD reviews

The contract term for this service agreement is one year, with the option for three one-year extensions to July 2022. The not-to-exceed contract amount for the first year of this contract is \$691,389, which provides for two primary employees, with limited supervision, and their travel expenses.

The breakdown of these costs is shown below.

Exhibit 13: BDO Annual Contract Costs, August 2018 – July 2019

	Annual Work Hours	Hourly Rate	Total Annual Rate	Annual Travel Cost	Total Annual Cost Per Employee
Employee 1	1089	\$185	\$201,465	\$88,605	\$290,070
Employee 2	1820	\$165	\$300,300	\$63,744	364,044
Supervisors	110	\$220	\$24,200	\$13,075	\$37,275
Total Annual BDO Team Costs:			\$525,965	\$165,424	\$691,389

Source: BDO Fully Executed Agreement

The City could reduce staff costs for bringing the financial services function in-house. Based on the contracted 2,109 hours of service for Employee 1 and Employee 2 below, we estimate that the City would need 1.6 FTE (full-time equivalent) positions to provide comparable services, with cost savings of \$334,141, as shown Exhibit 14 below.

Exhibit 14: Comparative Costs of In-House and Contracted Financial Services

Contract Services	Hours	Annual Cost	In-House City Services	FTE	Salaries & Fringe Benefits	Savings/ (Cost)
Employee 1	1,089	\$290,070	Financial Systems Supervisor	0.60	\$127,183	\$162,887
Employee 2	1,820	364,044	Accountant IV	1.00	179,305	184,739
Subtotal	2,909	\$654,114	Subtotal	1.60	\$306,488	\$347,626
Supervisors	110	37,275	Overhead		50,760	(13,485)
Total	3,019	\$691,389			\$357,248	\$334,141

Sources: BDO Contract, SF DHR Compensation Database

The BDO project team offers extensive experience in terms of public housing finance, and their work has enabled the Housing Authority and the City to understand the current financial circumstances with trusted data and analysis. This team will remain critical to correcting the financial management errors from previous years and ensuring the accuracy of future reporting, as the City assumes responsibility for essential functions.

However, following sufficient completion of the restructuring, the City should bring these financial operations in-house. The costs for

BDO staff exceed costs for comparable City employees, and the opportunity to ensure direct management of these essential financial functions will be important to the ongoing operations of the voucher and housing programs. The City should hire qualified financial supervisory staff, and work-order these employees to the Housing Authority for ongoing financial management.

In addition, the Executive Director of the Housing Authority should provide midyear reports on all financial and program operations to the Board of Supervisors for enhanced oversight and transparency.

➤ **The Housing Authority should adopt the City's financial system**

As it continues to receive funding from HUD for the provision and management of tenant- and project-based vouchers, as well as public housing assets, the Housing Authority will have ongoing reporting requirements. These reports include:

- Financial Data Statement (FDS) – similar to an annual report.
- Voucher Management reports
 - Housing Choice Voucher Utilization Report: details utilization of unit occupancy
 - Housing Choice Voucher Housing Assistance Payment Register Report: details related to expense period and extended resident information
- Public Housing Information Center (PIC)

The systems that the Housing Authority currently uses to record and report data include:

- Elite: (Housing Authority) tracks vouchers and maintains tenants' leasing activities for Public Housing
- Great Plains: (Housing Authority) general ledger
- VMS: (HUD) voucher management system
- Two-Year Tool (HUD): forecasting template to project future Housing Assistance Payment expenses by running basic leasing and spending scenarios

The proposed MOU submitted to the Board of Supervisors on July 9, 2019 provides for the Housing Authority to transition to a shared services model, in which the City provides services to the Authority, including human resources, information technology, purchasing,

real estate, and financial systems and oversight. According to the proposed MOU, the Housing Authority in conjunction with MOHCD, the Controller's Office, and the General Services Agency will develop a timeline for integrating systems, processes, and policies. Because of the complexity of integration, the Board of Supervisors should request regular reporting to the Board on the status of integration. Transition to the City's new financial system (FSP) is especially important so that the Controller's Office has direct access to the agency's information and can provide adequate oversight to ensure quality control and accuracy.

In addition, the Controller should have the same authority to serve as the Controller to the Housing Authority as he does other City departments.

➤ **The Housing Authority should expedite the disposition of non-housing assets surplus to the Housing Authority's operational requirements**

The Housing Authority owns the office building at 1815 Egbert Street. Because Housing Authority staff will be reduced, this building is potentially surplus. The proposed MOU submitted to the Board of Supervisors on July 9, 2019 provides for the Housing Authority and City to work together to locate Housing Authority operations in City-owned property if space is available. The proposed MOU further provides for the Housing Authority to inventory all non-housing assets and submit to the Controller's Office a plan for disposing of assets not needed for Housing Authority operations. Proceeds from the disposal of assets would be used to repay loans made by the City to the Housing Authority, subject to HUD's property disposition requirements.

The Board of Supervisors should request the Director of Real Estate to evaluate the space needs for continued Housing Authority operations, and the potential use of 1815 Egbert Street by the City, as part of the plan for disposition of Housing Authority non-housing assets.

Conclusion

The transition of Housing Authority functions to the City will require clearly-defined roles, accountability, and timelines. The Board of Supervisors should affirm, as a priority, the appointment of a Chief Executive Officer, accountable for the effective performance of the Housing Authority, and request regular reporting to the Board on the status of integration of Housing Authority systems.

Recommendations:

The Board of Supervisors should:

Recommendation 6: Request the Mayor to appoint a permanent Executive Director for the Housing Authority as a priority.

Recommendation 7: Request the Director of Real Estate to evaluate the space needs for continued Housing Authority operations, and the potential use of 1815 Egbert Street by the City, as part of the plan for disposition of Housing Authority non-housing assets.

The Transitions Team Leader and Housing Authority Executive Director, once appointed should:

Recommendation 8: Ensure that the core Housing Authority positions, particularly the contract managers, demonstrate the necessary competence to perform critical job duties.

The Housing Authority Executive Director, once appointed, should:

Recommendation 9: In consultation with the Controller, hire qualified financial staff to assume the duties currently filled through the BDO contract, following sufficient completion of the restructuring.

Recommendation 10: Provide a midyear report to the Board of Supervisors on program and financial performance of all Housing Authority activities, and status of integration of the Housing Authority's systems and policies with the City.

The Controller should:

Recommendation 11: Ensure that the Housing Authority transitions over to the City's financial system following the transitional phase of the restructuring.

Recommendation 12: Have the same authority to serve as the Controller to the Housing Authority as he does other City departments and agencies.

4 Human Resources

Based on HUD requirements, the City and the Housing Authority have determined that the administration of Housing Choice Vouchers will be contracted out to a third-party “expert”, through a competitive bid process. The selected contractor will provide eligibility determinations, housing inspections and all other program services. This outsourcing will result in the separation of nearly 200 current the Housing Authority employees. While the City intends to retain 10 to 12 core Housing Authority positions primarily for ongoing contract management, and has initiated efforts to identify potential City employment opportunities for qualified Housing Authority staff, the majority of the Housing Authority employees will either retire or accept a severance package. The estimated costs of severance packages could total \$5 million or more. According to the Housing Authority, agency reserves will be used for these payments. However, current reserve estimates do not appear sufficient to meet estimated severance package costs, presenting an additional financial risk to the City.

The Housing Authority will also have ongoing responsibility for the unfunded pension and other post-employment benefit liability for active and former the Housing Authority employees. the Housing Authority’s five-year financial projections show the Authority has sufficient funds to pay down \$20.9 million of the total unfunded pension liability of \$61.5 by the end of FY 2022-23. The sufficiency of funding to pay down the remaining \$40.7 million liability after FY 2022-23 is not known.

The sufficiency of the Housing Authority funding for severance payments and unfunded pension liabilities is not clear

- The costs of severance package payments may present an additional risk to the City

As of May 2, 2019, the Housing Authority employed 194 workers, in the following program and service areas:

Housing Authority	
Department/Program	# of Employees
Housing Choice Voucher	108
Public Housing - Admin	15
Public Housing - Craft	60
Central Office	11
Total Housing Authority Employees	194

Sources: Housing Authority Organization Chart; Housing Authority Employee Roster 5/2/19

Twenty of these employees are in confidential or non-represented classifications. The remaining 174 employees belong to one of the following 11 unions:

Labor Union	# of Housing Authority Members
Service Employees International Union (SEIU) Local 1021 Administration	85
Laborer Union Local 261	27
Municipal Executives Association (MEA)	21
Electrician Union Local 6	9
Carpenter Union Local 22	8
Plumber Union Local 38	8
Painter Union Local 1176	6
SEIU Local 1021 - Custodians	4
Glazier Union Local 781	2
Steamfitter Union Local 38	2
Lino Layer Union Local 12	2
Total	174

Source: Housing Authority Employee Roster 5/2/19

As shown, SEIU Local 1021 represents the largest number of Housing Authority employees. The current collective bargaining agreement between SEIU Local 1021 and the Housing Authority expires on September 30, 2019.

Approximately 10 positions will be retained to continue the operations of the restructured Housing Authority, as discussed in Section 3 of this report.

According to Mayor Breed's letter to Housing Authority employees dated April 9, 2019, "the City sought clarification from HUD on

whether the City could absorb and maintain the current structure of the HCV and LRPB programs as the third-party expert referenced in HUD's letter [dated March 6, 2019]. HUD stated that a City takeover of these functions with existing Housing Authority staff would not meet this requirement". This means that HUD requires the Housing Authority and the City to contract out for the management of the Housing Choice Voucher and Low Rent Public Housing programs.

The Mayor noted in her letter that, "The City remains committed to assisting the Housing Authority in addressing the impacts this transition will have on its employees. This includes working closely with the Housing Authority to design appropriate severance payments, and provide a robust set of assessments, training and counseling to identify options for impacted employees, including where possible and appropriate, opportunities for City employment."

As a result, the City and the Housing Authority have begun developing a phased program to support the transition of Housing Authority employees into City employment opportunities, with the expectation that Housing Authority employees (except for the remaining "core" positions) will transition out of the in phases over the next approximately two years.

Because of the upcoming expiration for the SEIU Local 1021 contract and the HUD requirement that HCV program management be contracted out as quickly as possible, the City and the Housing Authority plan to transition most of the HCV program employees by October 1, 2019. Procurement of the HCV contractor is in process.

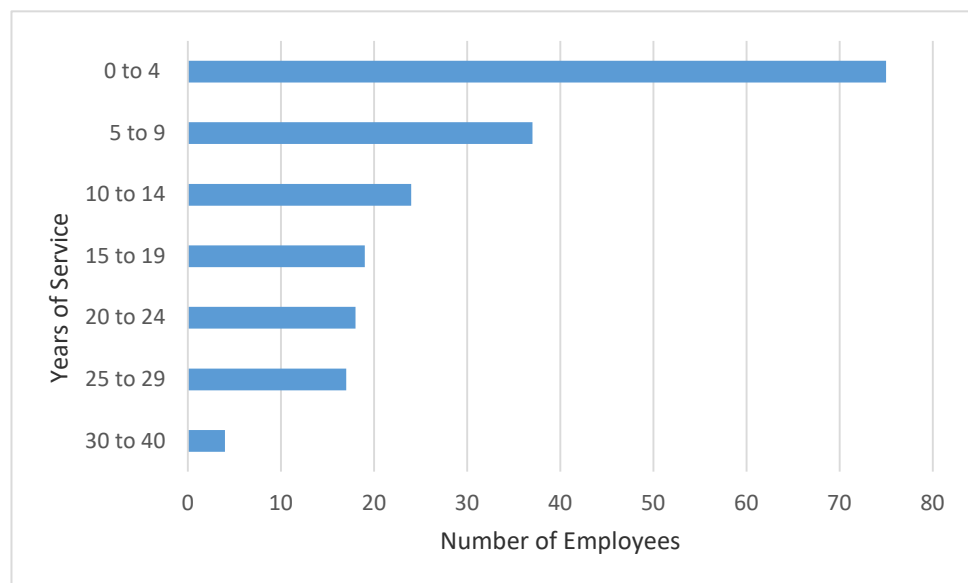
The Housing Authority is developing a transition plan for employees of the Public Housing; the transition is expected to occur in phases corresponding to the phased rehabilitation of the existing housing units and their conversion to private property management. The procurement of a third-party property management contractor, and the rehabilitation and conversion of all remaining public housing units, is scheduled to be completed by the second quarter of 2021.

The City and the Housing Authority continue to negotiate with the labor unions representing these employees through a meet-and-confer process to establish agreeable terms for transition plans and

severance payments. While the details of those negotiations remain confidential, we assume that the discussions likely reflect those that occurred during the staff restructuring for the RAD conversion. According to the respective collective bargaining agreements, severance payments equaled two weeks of pay per year of service.

To estimate the total costs of such packages, we reviewed employee service data. The following exhibit shows the distribution of years of service for all Housing Authority employees, as of May 2, 2019.

Exhibit 15: Years of Services, Housing Authority Employees



Source: Housing Authority Employee Roster 5/2/19

Nearly half (or 42 percent) of employees have worked at the agency for 10 years or more. Based on the employee data provided by the Housing Authority, the potential estimated costs for severance packages (assuming all employees accepted these offers) could be \$5 million or more.

While the Acting Executive Director of the Housing Authority notes that these severance payments will be made using the Housing Authority reserves, it is unclear from the current Five Year Projections that reserve funds will be sufficient to cover these costs. It is also unclear whether HUD considers this an allowable use of funds. We recommend that the Housing Authority work with BDO to re-evaluate the projections for reserves, and consult with HUD

regarding allowable uses of reserves. If there are estimated shortfalls for employee severance payments, the Housing Authority should immediately consult with the City regarding funding options.

➤ **The adequacy of funding for future unfunded pension liabilities is not certain**

The Housing Authority will have continued responsibility for the unfunded pension and OPEB (other post-employment benefits) of active and former employees. The Housing Authority employees who are members of trade unions (carpenters, electricians, floor layers, glaziers, laborers, painters, and plumbers) are eligible for pension benefits in accordance with their collective bargaining agreements under defined contribution plans. The Housing Authority employees who are members of MEA and SEIU are members of the California Public Employees Retirement System (CalPERS). According to BDO's five-year financial forecast, the projected unfunded liability in FY 2019-20 is \$61.5 million, as shown in Exhibit 16 below.

Exhibit 16: The Housing Authority Unfunded Pension and OPEB Liabilities

Unfunded Liabilities	FY 2019-20 Amount
CalPERS	\$20,000,000
Craft Pension	21,356,914
OPEB	20,192,838
Total	\$61,549,752

Source: BDO

According to BDO's five-year financial forecast, the Housing Authority will have sufficient net revenues in each year to pay down the unfunded liability, resulting in net liability of \$40.7 million as of September 30, 2023, as shown in Exhibit 17 below.

Exhibit 17: Projected Unfunded Liability as of September 30, 2023

FY 2019-20 Liability	\$61,549,752
FY 2020-21 Payment	(9,990,500)
FY 2021-22 Payment	(5,647,749)
FY 2022-23 Payment	(5,224,234)
2023 Liability	\$40,687,269

Source: BDO

Payment of the pension and OPEB liabilities through September 30, 2023 are projected to come from residual receipts from the ground leases between the Housing Authority and nonprofit operators of public housing, drawdown on reserves, and Asset Repositioning Fees from HUD¹⁷. The Housing Authority will continue to receive residual receipt payments from the ground leases that will be a source of funds to pay down the pension and OPEB liabilities, but the sufficiency of these payments to pay down the liabilities is not yet known.

Conclusion

The restructuring of the Housing Authority employees will result in transitioning of most workers out of the agency. The City and the Housing Authority are working together with the respective labor organizations to design severance packages for these workers. The Housing Authority will need to ensure that funds are available to cover these costs.

The Housing Authority will have continuing responsibility for unfunded pension and OPEB liabilities. According to the Housing Authority's five-year financial projections through 2023, net revenues should be sufficient to pay down the unfunded liability, but the sufficiency of funding after 2023 is not yet known.

Recommendations

The Acting Executive Director of the Housing Authority should:

Recommendation 13: Work with BDO to evaluate and confirm final projections for reserves that would be available for severance payments for exiting employees.

Recommendation 14: Consult with HUD to determine whether employee severance payments are an allowable use of reserve funds, in accordance with federal policy.

Recommendation 15: Work with the City to identify other possible funding options for severance payments if reserves are insufficient or not eligible for this use.

The Executive Director of the Housing Authority, once appointed, should:

Recommendation 16: Report annually to the Board of Supervisors on the Housing Authority's unfunded pension and OPEB liability and available funds to pay down the unfunded liability.

¹⁷ HUD will pay the Housing Authority an Asset Repositioning Fee of approximately \$10.3 million to defer the costs of the RAD conversion of public housing.

Conclusion, Costs and Benefits

When HUD determined that the Housing Authority was in substantial default under the Housing Choice Voucher and public housing programs, HUD had the option to place the Housing Authority in receivership, taking possession of all or part of the Housing Authority. The City's choice, with HUD's agreement, to assume the essential functions of the Housing Authority will likely provide better services and protections to Housing Authority residents than if HUD had placed the Housing Authority in receivership.

The restructuring of the Housing Authority and assumption of the City of the Authority's essential functions creates financial and operational risks for the City. The Mayor will need to make an early appointment of an Executive Director to be responsible and accountable for the restructuring, and negotiate with HUD to ensure sufficient oversight of the Housing Authority and conformance to City Charter and Administrative Code provisions.

The recommendations in the report should be able to be implemented within existing resources, without incurring new costs. These recommendations are intended to increase transparency and oversight of the transfer of the Housing Authority to the City in order to mitigate potential risks. To the extent that the recommendations result in increased efficiency to the City and the Housing Authority, the City and Housing Authority should be able to reduce their financial and operational risk.

Mayor's Office of Housing and Community Development

and

Transition Team Leader

Written Response and Recommendation Matrix

Mayor's Office of Housing and Community Development
City and County of San Francisco



London N. Breed
Mayor

Daniel Adams
Acting Director

Date: September 4, 2019

To: Severin Campbell, Director
Budget and Legislative Analyst's Office
Board of Supervisors

From: Tonia Lediju, PhD, San Francisco Housing Authority Transition Team Lead
Office of the Mayor

Daniel Adams, Acting Director
Mayor's Office of Housing and Community Development

Subject: *Response to the Performance Audit of the City's Assumption of the San Francisco Housing Authority's Essential Functions*

The San Francisco Housing Authority Transition Team (Transition Team) and the Mayor's Office of Housing and Community Development (MOHCD) appreciate the efforts of the Board of Supervisors' Budget and Legislative Analyst's Office in conducting a performance audit of the assumption of the essential functions of the San Francisco Housing Authority (SFHA) by the City and County of San Francisco (City). Of the audit report's 16 recommendations, the Transition Team and MOHCD agree with 12 and disagree with 4. The Transition Team and MOHCD are committed to ensuring success in the transition of SFHA from a direct provider of housing vouchers and public housing programs to a high-functioning contract management, compliance, and reporting agency that provides excellent customer service and ensures compliance with U.S. Department of Housing and Urban Development (HUD) requirements. The complete responses of the Transition Team and MOHCD to the audit recommendations are attached and responses to key recommendations are briefly highlighted below.

The Transition Team and MOHCD agree that it is of utmost importance to establish new leadership for SFHA by appointing a permanent executive director following the current transition, and to ensure SFHA staff demonstrates the necessary competence to perform critical job duties through rigorous performance planning and evaluation processes. The Transition Team and MOHCD also agree that SFHA and its Board of Commissioners should establish additional processes to report to the City and Board of Supervisors, such as regular reports of SFHA's housing voucher program funding levels and shortfalls, programmatic and financial performance, operating budget, and liabilities of unfunded pension and other post-employment benefits. The Transition Team will work with the City to evaluate space needs for SFHA's continued operations and plan for dispositions of any non-housing assets not required for the agency's foreseeable operational needs and identify funding options for employee severance payments.

SFHA's Organizational Status. Due to HUD requirements and state law, SFHA must remain a separate legal entity from the City; it cannot be structured in the same manner as other city departments. Chartered under state law, a housing authority is an autonomous, public body, corporate and politic, and must be a separate legal entity from the city or county which created it. To that end, state law dictates the governance structure of all housing authorities in California and charges oversight of each housing authority to its governing board. A housing authority's governing board, typically appointed by local government officials, is the only body that is authorized to set and clarify the housing authority's goals, approve the housing authority's policy, and delegate the board's responsibility and authority to the executive director, who acts on the board's behalf. HUD directly funds SFHA and requires that its relationship remain only with SFHA and its Board of Commissioners. The Transition Team and MOHCD have confirmed that HUD will not permit the Board of Supervisors or other city departments to have approval authority over transactions that use HUD funding and are approved by HUD and SFHA's Board of Commissioners. Therefore, the Transition Team and MOHCD disagree with the audit recommendation that SFHA operate in the same manner as other City departments and conform to all of the City's requirements for its departments.

However, we agree that some structural changes are needed for SFHA. The proposed Memorandum of Understanding (MOU) submitted to the Board of Supervisors on July 9, 2019, which is subject to HUD's final approval, endeavors to strike a balance between recognizing the requirements of HUD and the separate legal entity status of SFHA, and the need for the City to play a greater role in SFHA's operations. This is precisely why the MOU contemplates the Mayor's Budget Office and Controller's involvement in the crafting of SFHA's annual budget, a mix of appointments to the SFHA Board of Commissioners (four by the mayor and three by the Board of Supervisors), designation of senior leadership staff by the mayor, and involvement by the City's Department of Real Estate in reviewing and analyzing SFHA's non-housing assets.

Approvals over SFHA's Property Transactions. As noted above, HUD will not permit the Board of Supervisors or other City departments to have approval authority over SFHA transactions, which includes property transactions. In addition, California Health and Safety Code Section 34320, states that "no law concerning the acquisition, operation, or disposition of property by other public bodies is applicable to an [a housing] authority unless the Legislature specifically so states." Thus, state legislative action would also be needed to implement this audit recommendation. Any action by the City related to an already-approved agreement (lease, development agreement, or other contract) by HUD cannot deviate from what the City, SFHA, and HUD have agreed to in their agreement. The proposed MOU does not expressly grant any rights to the City or SFHA to retroactively change any portion of the HUD-approved agreements. Last, under the terms of its annual contributions contracts with HUD, SFHA must receive HUD's permission to change its public housing stock. (Demolition and disposition of public housing is governed by of the U.S. Housing Act, Section 18.) Therefore, the Transition Team and MOHCD disagree with the audit report's recommendation to negotiate with HUD to provide the Board of Supervisors with an oversight role in contract and lease approvals and property transactions.

We expect the scope of property transactions that will involve HUD and SFHA operations to be relatively limited at this time and primarily confined to the disposition and revitalization of the Sunnydale and Potrero Public Housing Sites. The Board of Supervisors adopted Master

Development Agreements that govern the disposition and development of these sites on January 31, 2017 by resolutions 19-17 and 20-17, and are binding on the City and SFHA. Any City funding to assist with the revitalization will comply with the City's requirements, including any approvals by the Board of Supervisors. Also, any disposition of SFHA's non-housing assets, such as the Egbert Avenue property, will be done in compliance with HUD requirements (which include an appraisal for fair market value) and can be included in regular status reports to the Board of Supervisors. After completion of the Sunnydale and Potrero sites and disposition of the Egbert Avenue property, SFHA will have little remaining property assets.

The City Controller Cannot Be SFHA's Controller. The Transition Team and MOHCD disagree with the report's recommendations that the City's controller (or Controller's Office) should have the same authority to be SFHA's controller and that SFHA should be integrated into the City's financial system. As stated above, SFHA must remain a separate legal entity from the City and cannot be considered a component of the City or any other primary government, as defined by the Governmental Accounting Standards Board (GASB), as its Board of Commissioners independently oversees its operations. SFHA is subject to HUD's financial reporting, budget, and voucher management requirements, which are distinct from the City's financial processes. Also, SFHA uses a different fiscal year (October 1st to September 30th) than the City does. However, in order to ensure the competence of SFHA financial staff as well as manage any potential future shortfalls, the city Controller's Office has been an active participant in the Transition Team, which is focused on restructuring SFHA. Also, the MOU contemplates the continued involvement of Controller's Office staff during the preparation of SFHA's budget. Therefore, the Transition Team and MOHCD believe it is best for SFHA to retain its current financial systems until a compatible alternative system is identified. Any such system must meet HUD's financial reporting and voucher management requirements.

We look forward to our continued work with the Board of Supervisors, relevant city departments, HUD, community stakeholders, and most importantly, our residents, as we implement these comprehensive improvements.

Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
1	The Board of Supervisors should request MOHCD and the Housing Authority to report at least once per year to the Board of Supervisors after the December close on the level of funding of the housing voucher program. This report should include information on (1) current utilization, (2) funding levels and year-to-date funding shortfalls, (3) changes in fair market rents, (4) details on the financial conditions of both project-based and tenant-based vouchers, and (5) status of the application for and availability of supplemental shortfall funding to cover the Housing Authority shortfalls.	3	Agree	The Transition Team and MOHCD agree that the Housing Authority should regularly report to the Board of Supervisors on the housing voucher program's funding levels, utilization, and shortfalls.
2	The Board of Supervisors should request the Mayor, Controller, and Budget and Legislative Analyst, when preparing the City's five-year financial projections, to consider potential reductions in Housing Assistance Payments to the Housing Authority and potential impact to the Housing Trust Fund or City General Fund if the City were to backfill reductions in federal funding.	3	Agree	The Transition Team and MOHCD agree that the Controller's Office and the Budget and Legislative Analyst should consider potential reductions in Housing Assistance Payments and the potential impacts of those reductions to the Housing Trust Fund or the City's General Fund if the City were to backfill reductions in federal funding.
3	The Housing Authority Executive Director and MOHCD Director should notify the Board of Supervisors regarding the emergence of a funding shortfall that will require supplemental funding from HUD and/or a supplemental appropriation from the City immediately after the cause and amount of these shortfalls become known.	1	Agree, with qualifications	The Transition Team and MOHCD agree that the Housing Authority should notify the Board of Supervisors regarding the emergence of a funding shortfall. The Housing Authority is required to first confirm with HUD the amount of any funding shortfall and apply for available funding to cover it, and then communicate to the City whether a supplemental appropriation is needed.

Priority 1 recommendations should be completed by January 31, 2020

Priority 2 recommendations should be completed by June 30, 2020

Priority 3 recommendations should be completed by December 31, 2020

Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
4	<p>The Board of Supervisors should request the Mayor and the Acting Executive Director of the Housing Authority to negotiate with HUD on the Housing Authority's accountability to the Board of Supervisors in conformance to the City Charter and Administrative Code, including annual budget review consistent with HUD requirements, contract and lease approvals above relevant thresholds, and property transactions to confirm conformance with the terms of the respective development agreements.</p>	1	Disagree	<p>The Transition Team and MOHCD do not agree that the Mayor and Housing Authority should negotiate with HUD on the Housing Authority's accountability to the Board of Supervisors. HUD directly funds the Housing Authority and requires that its relationship remains only with the Housing Authority and its Commission. The Transition Team and MOHCD have confirmed that HUD will not permit the Board of Supervisors or other city departments to have approval authority over transactions that use HUD funding and are approved by HUD and the Housing Authority's Commission.</p> <p>The proposed MOU creates a procedure in which the Housing Authority's adoption of an annual budget is subject to review and approval by the mayor and Board of Supervisors, either of which may accept or reject the Commission's proposed budget, and consistent with city procedures and HUD schedules and requirements. After negotiation, HUD has approved this.</p> <p>Any city action related to an already-approved agreement (lease, development agreement, or other contract) cannot deviate from what the City, the Housing Authority, and HUD agreed to in their agreements. The proposed MOU does not expressly grant any rights to the City or Housing Authority to retroactively change any portion of the HUD-approved agreements. Therefore, the Transition Team and MOHCD disagree with the audit report's recommendation to negotiate with HUD to provide the Board of Supervisors with an oversight role in contract and lease approvals and property transactions.</p>

Priority 1 recommendations should be completed by January 31, 2020

Priority 2 recommendations should be completed by June 30, 2020

Priority 3 recommendations should be completed by December 31, 2020

Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
5	The Board of Supervisors should adopt an ordinance to amend Chapter 12, Section 12.2 of the Administrative Code to codify the Housing Authority Commission structure adopted by the Board.	2	Disagree	The Transition Team and MOHCD do not agree that the City should adopt an ordinance to amend Chapter 12, Section 12.2, of the Administrative Code to codify the Housing Authority Commission structure. Under the California Health and Safety Code, Section 34270.1, the mayor has the sole authority to appoint all seven commissioners. The proposed MOU creates a procedure in which the Board of Supervisors recommends three members, with the mayor appointing those members. Although the mayor can agree to appoint members selected by the Board of Supervisors under the MOU, a city law cannot be adopted that would conflict with state law. Section 12.2 may be amended to reflect the requirements of Heath and Safety Code Section 34270.1.
6	The Board of Supervisors should request the Mayor to appoint a permanent Executive Director for the Housing Authority as a priority.	1	Agree	The Transition Team and MOHCD agree that the mayor should appoint a permanent executive director of the Housing Authority following the current transition.
7	The Board of Supervisors should request the Director of Real Estate to evaluate the space needs for continued Housing Authority operations, and the potential use of 1815 Egbert Avenue by the City, as part of the plan for disposition of Housing Authority non-housing assets.	2	Agree	The Transition Team and MOHCD agree to coordinate with the Department of Real Estate to evaluate space needs for the continued Housing Authority operations and plan for dispositions of any non-housing assets not required for the agency's foreseeable operational needs.
8	The Transitions Team Leader and Housing Authority Executive Director , once appointed, should ensure that the core Housing Authority positions, particularly the contract managers, demonstrate the necessary competence to perform critical job duties.	1	Agree	The Transition Team and MOHCD agree to ensure staff in core Housing Authority positions demonstrate the necessary competence to perform critical job duties.

Priority 1 recommendations should be completed by January 31, 2020

Priority 2 recommendations should be completed by June 30, 2020

Priority 3 recommendations should be completed by December 31, 2020

Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
9	The Housing Authority Executive Director , once appointed, should in consultation with the Controller hire qualified financial staff to assume the duties currently filled through the BDO contract, following sufficient completion of the restructuring.	3	Agree, with quali- fications	<p>The Transition Team and MOHCD agree to coordinate with the Controller's Office in the recruitment of qualified staff and explore options for shared-services with the City for the Housing Authority's financial functions. In order to ensure the competence of SFHA financial staff as well as manage any potential future shortfalls, the city Controller's Office has been an active participant in the Transition Team, which is focused on restructuring the Housing Authority. Also, the MOU contemplates the continued involvement of the Controller's Office during the preparation of the Housing Authority's budget.</p> <p>The Housing Authority has experienced extreme difficulties recruiting and retaining qualified finance staff due to the specialized knowledge the positions require. As such, the Housing Authority contracted out its financial functions to BDO and must continue to do so because HUD has required the contracting out of the Housing Authority's essential functions, including financial functions. It is important to note that the complete absorption of financial functions rather than outsourcing is inconsistent with HUD's directive.</p>
10	The Housing Authority Executive Director , once appointed, should provide a midyear report to the Board of Supervisors on program and financial performance of all Housing Authority activities, and status of integration of the Housing Authority's systems and policies with the City.	3	Agree, with quali- fications	<p>The Transition Team and MOHCD agree that the Housing Authority should provide midyear reports to the Board of Supervisors on the agency's programmatic and financial performance and the status of adopting appropriate policies and procedures that the City recommends.</p>

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Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
11	The Controller should ensure that the Housing Authority transitions over to the City's financial system following the transitional phase of the restructuring.	3	Disagree	The Transition Team and MOHCD do not agree to have the Housing Authority move to the City's financial system. The City's financial system is not designed for public housing agencies and is not equipped with specialized functionalities to track vouchers or maintain tenants' leasing activities, which are required to be reported to HUD. As such, the Transition Team and MOHCD believe it is best for the Housing Authority to retain its current financial systems until a compatible alternative system is identified. Any such system must meet HUD's financial reporting and voucher management requirements.
12	The Controller should have the same authority to serve as the Controller to the Housing Authority as he does other City departments and agencies.	1	Disagree	The Transition Team and MOHCD do not agree that the City's controller (or Controller's Office) should have the same authority to be the Housing Authority's controller. The Housing Authority must remain a separate legal entity from the City and cannot be considered a component of the City or any other primary government, as defined by the GASB, as its Commission independently oversees its operations. The Housing Authority is subject to HUD's financial reporting, budget, and voucher management requirements, which are distinct from the City's financial processes. Also, the Housing Authority uses a different fiscal year (October 1st to September 30th) than the City does.
13	The Acting Executive Director of the Housing Authority should work with BDO to evaluate and confirm final projections for reserves that would be available for severance payments for exiting employees.	1	Agree	The Transition Team, Housing Authority, and BDO have evaluated and confirmed the final projections for reserves that would be available for severance payments for exiting employees.
14	The Acting Executive Director of the Housing Authority should consult with HUD to determine whether employee severance payments are an allowable use of reserve funds, in accordance with federal policy.	1	Agree	The Transition Team, MOHCD, and Housing Authority have consulted with HUD to determine whether employee severance payments are an allowable use of reserve funds, and will continue to have ongoing consultations with HUD should there be significant changes to the agency's financial condition and available funding.

Priority 1 recommendations should be completed by January 31, 2020

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Budget and Legislative Analyst's Recommendations

	Recommendation	Priority	Dept Agree/ Disagree	Department Comments
15	<i>The Acting Executive Director of the Housing Authority</i> should , work with the City to identify other possible funding options for severance payments if reserves are insufficient or not eligible for this use.	1	Agree	The Transition Team, MOHCD, and Housing Authority are in consultation with the City to identify other possible funding options for employee severance payments.
16	<i>The Executive Director of the Housing Authority</i> , once appointed, should report annually to the Board of Supervisors on the Housing Authority's unfunded pension and OPEB liability and available funds to pay down the unfunded liability	3	Agree	The Transition Team and MOHCD agree that the Housing Authority should report annually to the Board of Supervisors its unfunded pension and OPEB liability and available funds to pay down the unfunded liability.

Priority 1 recommendations should be completed by January 31, 2020

Priority 2 recommendations should be completed by June 30, 2020

Priority 3 recommendations should be completed by December 31, 2020