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## **REVITALIZING LOW-INCOME HOUSING**

### INTRODUCTION

Despite mounting concerns that housing assistance costs are skyrocketing out of control without improvement in services to those most in need, the Senate Banking, Housing and Urban Affairs Committee will soon be sending to the Senate floor a \$17.6 billion housing authorization bill that is seriously flawed. The Senate bill incorporates the President's market-oriented housing assistance voucher program, but it is a poor compromise with the \$24.6 billion House bill (which relies heavily on traditional methods of public construction and subsidization of new housing and contains no provision at all for vouchers). It will therefore do little to revitalize America's dismal low-income housing efforts.

Neither bill addresses the fundamental inefficiencies and inequities that pervade every federal housing program. To make matters worse, the Senate's housing voucher provisions commit new funds to the program, rather than transferring appropriations from existing programs. Senator William Armstrong (R-Colo.) has raised the disturbing point that the housing voucher program could mushroom into an enormous new entitlement bonanza. Before the Senate sends the bill to conference, it must accommodate Armstrong's concerns.

President Reagan asked Congress to amend the section 8 existing housing program to provide cash-equivalent vouchers to low-income households directly. These could be used to pay rent, instead of the federal government's paying landlords on the tenants' behalf. This change would provide tenants with maximum freedom of choice in housing, and it would tend to minimize landlord incentives to inflate rents. The President also would like the Department of Housing and Urban Development (HUD) to stop constructing costly public housing and subsidizing new private rental construction.

Evidence from the Experimental Housing Allowance Program (EHAP) in the 1970s demonstrates that a voucher program promises significant benefits in efficiency and equity over the present mix of programs.<sup>1</sup> Armstrong fears, however, that housing vouchers will turn out to be merely a euphemism for "rent stamps," leading to a repeat performance of the ballooning budgets and abuses associated with food stamps and many other entitlement programs. Noted the Senator recently in the Congressional Record, "such a gift to some eligible families but not others is grossly discriminatory. Congress is likely to resolve such a dilemma by agreeing to expand the program to all who qualify.... The bill in effect creates an ocean of demand and irresistible political pressure to fulfill that demand." Without stringent restrictions on the voucher program, Armstrong's prophesies are likely to come true.

Significant changes must be made in the Senate bill, if it is to prevent vouchers from turning into a entitlement and restore fiscal sanity to this year's HUD budget. The Senate should start by refusing to authorize any new commitments to public housing and striking out any allowance for the construction of new low-income housing, public or private, which is directly financed with public monies. Instead, existing funds should be used more effectively to house low-income families.

Efforts should be made to convert existing subsidies into state-administered housing vouchers, instead of using new funds for a federally operated program. Congress should reduce the likelihood of vouchers becoming a major new entitlement program by apportioning a fixed amount of funds to the states in the form of block grants, with only broad oversight and eligibility guidelines provided by HUD. This would allow each state to distribute and administer funds as it found most efficient. From the beginning, the voucher program should be designed and operated by the states, within the constraints associated with a federal grant. If a state were to elect to relax eligibility criteria, it could do so, but total outlays would have to conform to the grant.

It is almost impossible, of course, to guarantee that a program will not become a budget busting entitlement, but establishing the housing voucher as a state program--with the federal funding gradually decreased over several years--would reduce this possibility significantly. In its present form, the Senate's housing voucher proposal is almost sure to fail in its objective of ensuring adequate housing for poor people while avoiding runaway program costs.

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<sup>1</sup> C. Peter Rydel and Jouh E. Mulford, "Consumption Increases Caused by Housing Assistance Programs," R-2809-HUD (Santa Monica, California: Rand, April 1982). See also Experimental Housing Allowance Program, Conclusions 1980 Report, HUD-PDR, November 1980.

## FEDERAL CONSTRUCTION OF LOW INCOME HOUSING: HISTORY AND PROBLEMS

There are two contradistinct strategies for providing housing assistance to low-income households: (a) the "supply" strategy, under which the government constructs or subsidizes the construction of new housing that meets certain standards, which is then rented to low-income households below cost; and (b) the "demand" strategy, under which the government augments the income of low-income households, either indirectly through payments to landlords or directly through vouchers, so that tenants, in effect, can pay the market price for housing. The former approach increases the supply of housing directly, while the latter increases it indirectly through the private market's response to an increase in demand. In recent years, the emphasis has shifted from a supply strategy, dominated by federally constructed housing projects, toward demand strategies, such as the section 8 existing housing program.

When housing assistance was first introduced during the Depression, legislators favored federal construction of public housing because the private sector was not relieving the general shortage of adequate rental housing. First authorized in 1937, the nation's public housing program subsidizes the development and financing of new and rehabilitated projects that are owned by local public housing authorities (PHAs) and made available at low rents to low-income households. In addition to paying all debt-service costs, the federal government pays some operating expenses for the projects. By 1982, the approximately 1.5 million subsidy commitments amounted to \$2.8 billion.

According to some studies, the private sector still fails to supply enough reasonable housing to low-income households. This has led many politicians to argue that more public housing is needed. Yet a Rand Corporation analysis reveals that, compared with most price indices, rents are actually declining.<sup>2</sup> HUD Secretary Samuel R. Pierce shares this view. "Our research has confirmed," he notes, "that in most localities the supply of decent housing is sufficient to meet the needs of low-income families. The major problem is inability to afford rents that cover debt service and maintenance. The housing certificate program is ideally suited to solve that problem at minimum cost to the Treasury."<sup>3</sup>

Not only is there no longer any clear need for new federally constructed housing, but federal construction has proved to be an expensive and ineffective method of providing new housing. Seven studies published since 1968 report that federal red tape, delays,

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<sup>2</sup> Ira S. Lowry, Rental Housing in the 1970's: Searching for the Crisis, unpublished draft prepared for Office of Policy Development and Research, U.S. Department of Housing and Urban Development, April 1981.

<sup>3</sup> Letter to the editor, New York Times, March 23, 1983.

regulations such as Davis-Bacon, and cost-plus pricing can make public construction twice as expensive as similar privately constructed housing.<sup>4</sup> According to a 1982 HUD study, 82 developers surveyed by the agency agreed that section 8 new construction costs were higher than those of equivalent unsubsidized housing--the Davis-Bacon Act alone was deemed to be responsible for a 10 percent boost in costs.<sup>5</sup>

Publicly funded new housing distorts the supply of new and rehabilitated private housing. The Rand Corporation concluded that "the private market offsets most of the new dwellings provided by the supply strategy...because dwellings vacated by program participants as they move into publicly provided dwellings become excess supply in the private market, which decreases the demand for private new construction. For every 100 units added by the supply strategy, housing starts in the private market decrease by 86 units according to Swan and by 80 units according to Murray<sup>6</sup>.... Thus the supply strategy increases housing supply by only one-tenth of a housing unit per participant."<sup>7</sup>

#### FROM EHAP TO SECTION 8 HOUSING: DEMAND STRATEGY EXPERIMENTS

The alternative demand strategy evident in President Reagan's voucher program has been under discussion ever since public housing was introduced in the 1930s. It was not until the Experimental Housing Allowance Program (EHAP) was inaugurated in 1970, however, that a demand strategy was initiated. EHAP was a major pilot study containing three experiments: a demand experiment, which tested the effects of the program upon the behavior of tenants; a supply experiment, which tested the reactions of housing suppliers; and an administrative experiment, which explored a variety of administrative methods for obtaining the most cost-effective procedures. The experiment involved twelve diverse U.S. housing markets. Various methods and formulas were employed, but the central feature was a direct payment to tenants equal to the difference between the "fair market rent," based on the local average rent for comparable housing and a contribution made by the tenant (which was a fixed percentage of the household's income). It was on the findings of this experiment that both the section 8 housing programs and the new voucher assistance proposals were modeled.

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<sup>4</sup> "Consumption Increases...", op. cit.

<sup>5</sup> Cost of HUD Multifamily Housing Programs, The Office Policy Development and Research, U.S. Department of Housing and Urban Development, 708, October 1982.

<sup>6</sup> Craig Swan, "Housing Subsidies and Housing Markets," Housing in the 70s Working Papers 2, HUD, pp. 833-841. Michael Murray, "Tenant Benefits in Alternative Federal Housing Programs," Urban Studies, Vol. 17, 1980, pp. 25-34.

<sup>7</sup> "Consumption Increases," op. cit., p. 3.

The section 8 rental assistance program was first authorized in 1974. Now the country's largest and most rapidly growing housing assistance program, it subsidizes lower-income households living in newly built, rehabilitated, or existing, adequate buildings. The section 8 new and substantially rehabilitated housing program stimulates the construction and major improvement of private housing, provided a specified percentage of the residents are low-income households, by guaranteeing to the landlord that his low-income tenants will be able to pay the "fair market rent" thanks to a subsidy sent directly to the landlord. The existing housing program involves similar payment to landlords of units already constructed. In each case, the subsidy is on the difference between the "fair market rent" and a certain percentage of the tenant's income (now 30 percent)--in effect an income subsidy to the tenant, paid directly to the landlord.

Though the section 8 new housing program has been an improvement over the construction of public housing projects, it is still more expensive than independent private construction or the existing housing program. One study estimated that the subsidy to each new unit of section 8 housing costs over \$6,000 per year, compared with \$2,300 for section 8 existing housing.<sup>8</sup> According to a GAO report, section 8 new housing government subsidies are used to construct "luxury or near-luxury" housing, thereby crowding out privately financed new construction and the rehabilitation of much less expensive existing stock. The existing housing program, on the other hand, has been far less extravagant.<sup>9</sup>

As the relative cost efficiencies of the various elements of section 8 became clear, pressure mounted to modify the program. Last year Congress finally took action. Funds were voted to continue the existing housing segment of section 8, but no funds were made available for more units of either new construction or substantial rehabilitation.

#### Major Defects of the Current Programs

The current program mix of housing assistance is extremely inequitable because the number of households meeting eligibility requirements greatly exceeds the number of financial commitments HUD can contract under present funding ceilings. Households with incomes below 50 percent of the area median are technically eligible for section 8 existing housing, but in practice some families with incomes far below this limit are left unassisted, while families only just within eligibility limits are served. For instance, of 2.2 million families with income below 20 percent of median only 0.5 million are served, while 1.7 million

<sup>8</sup> Federal Housing Assistance and Alternative Approaches, Congressional Budget Office, May 1982.

<sup>9</sup> "How to House More People and Lower Costs Under the Section 8 New Construction Program," GAO CEO-81-54, March 6, 1981.

are left unserved. Meanwhile, 0.4 million households with incomes over 40 percent of median income are served under the program.<sup>10</sup>

The same inequities exist within the new housing program. According to the GAO, "the section 8 program is inequitable in the sense that there is insufficient funding available to help the millions of households in need of housing assistance. This inequity is further exaggerated by the disparities in the quality of housing provided under the program. Some families are assisted with housing modest in nature, while others are assisted with housing which, at least, approaches the luxury category."<sup>11</sup>

## VOUCHERS

The section 8 existing housing program provides the legislative base of the Administration's certificate (or voucher) proposal. The section 8 program could be transformed into a voucher system by providing low-income households with direct assistance, rather than paying the landlords according to a contract. Under a voucher system, households would receive a fixed assistance grant based on their income, and they would be allowed to apply the grant to the rental unit of their choice, provided that it met minimum physical standards. Tenants would pay the difference between the contractually agreed rent and the value of their certificate. Therefore, there would be a considerable incentive for the tenant to find the least expensive unit that met his particular needs. If he chose a dwelling costing more than the area standard, he would have to pay all the added expense. If he found a unit at a lower cost, he could claim the savings as a reward for prudent shopping.

HUD Secretary Samuel R. Pierce has noted that there are incentives for landlords to inflate rents under "the current section 8 program, which establishes a ceiling (legislated maximums) on the rent that can be paid for housing--and frequently means higher rents for subsidized housing units than for comparable unassisted units. At times, the ceiling has also prevented families from moving to better housing or neighborhoods even when they were willing to pay more to do so."<sup>12</sup> A voucher system lessens the incentive for landlords to increase rents to the level permitted under the section 8 program, because every dollar charged above the voucher payment comes directly from the tenant's pocket. Thus the price of rented housing would be restrained. Under section 8, on the other hand, the government pays the extra dollar the landlord charges. If the value of the vouchers were to be held down to about \$2,150 per unit per year, the voucher

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<sup>10</sup> In correspondence to the author from Jill Khadduri, Director Policy Development, HUD, April 1983.

<sup>11</sup> "How to House....," op. cit.

<sup>12</sup> Letter to the editor, The New York Times, March 23, 1983.

program could cost as much as 8 percent below that of the present section 8 existing housing, and 40 percent below the current mix of programs.<sup>13</sup>

The experience with EHAP suggests strongly that vouchers would be the most efficient means of providing low-income housing. The following conclusions may be drawn from the experiment:

1. There is a sufficient stock of existing housing. The problem is that substandard housing is unprofitable for landlords to rehabilitate, given aggregate rental demand and government competition and controls. As a walk through the South Bronx will confirm, this has led to the abandonment of a significant part of the housing stock.

2. The amount of maintenance and rehabilitation needed to bring the stock of existing housing up to a reasonable standard is relatively modest.

3. The supply of adequate housing is sufficient to meet the short-run needs of low-income households. A HUD study of the Experimental Housing Allowance Program concluded "it is clear that even in the short run the supply of housing services from existing structures (rehabilitation) does respond to changes in rents (vouchers)," because the dollar commitment necessary to bring much of our substandard housing up to standard is quite low.<sup>14</sup>

4. As a result of these supply and demand characteristics, noted the same HUD study, "the supply experiment has laid to rest the fear that a full-scale housing allowance program would drive up housing prices substantially. It also has dispelled the belief that such a program would do almost nothing to increase the supply of decent, safe, and sanitary housing."<sup>15</sup> Vouchers, in other words, lead to increased rehabilitation, and not increased rents, as some critics had feared.

#### Conservative Objections to Vouchers

Conservative concerns about the voucher proposal stem from the fact that the existing rent support program assists only a fraction of the potentially eligible households. Federal money reaches fewer than 30 percent of the households meeting the eligibility standard. If housing certificates were to be implemented, conservatives feel that it would be too easy for liberals to turn the program into an open-ended entitlement program. If all 12 million eligible households applied for and participated in a voucher program, the total cost could approach \$20 billion a year.

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<sup>13</sup> Experimental Housing Allowance Program, op. cit.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

These conservative apprehensions are not unreasonable, given the experience of the food stamp program. Food stamps were begun in 1962 as a supplement to federally provided supplies of excess food. It was assumed that the program would remain small if it were administered at the local level and its recipients were required to make a payment for the stamps. Unfortunately, food stamps became a perfect vehicle whereby liberals could promote federal entitlements. The federal government gradually exercised more and more control over the program. First, Congress required uniform payments across the country, then in 1978 it abolished the recipient contribution. As a result, food stamps have grown from a simple \$14 million food supplement program into a \$12 billion entitlement wracked with fraud and abuse.

#### REFORMING FEDERAL HOUSING PROGRAMS

The authorization bills, in their present form, do little to limit the inefficiencies inherent in the current housing programs, or to concentrate help on those families most in need. Several key reforms, therefore, should be considered by the Congress in the authorization process.

No New Funding: Funding for the voucher program should be transferred from previous appropriations to other housing programs. New funding should not be authorized for public housing assistance, given the waste and inequities in the current mix of housing programs. Since vouchers would be much less costly than existing programs, approximately 90,000 more households could be assisted without the need for new funds.<sup>16</sup>

Modifying Contracts: HUD should try to "buy out" of existing contracts with landlords of section 8 existing housing, and with developers of new section 8 dwellings or public housing, in cases where vouchers would be a less expensive form of subsidy. Instead of allowing local housing authorities to demolish or sell obsolete projects, moreover, Congress should require local PHAs to sell projects whenever the present value of future operating subsidies plus debt service costs exceeds the cost of the vouchers needed to rehouse tenants minus the sale price of the project. According to a 1972 HUD study, vouchers would be more economical for about half of all PHA projects, without even accounting for receipts from sales.<sup>17</sup>

Targeting Assistance: The maximum number of households should be aided with the minimum payment necessary to induce them to live in acceptable housing within the aggregate budget authority. The Senate should therefore adopt the Administration's recommenda-

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<sup>16</sup> "Federal Housing Assistance....," *op. cit.*

<sup>17</sup> "Alternative Operating Subsidy Systems for the Public Housing Program," HUD-698, June 1972.



tion that the standard rent level for assistance be set at the 40th percentile of all recently rented housing. This compares with the 45th percentile adopted by the Senate committee and the 50th percentile figure in the House bill. HUD estimates that the difference between the House and Administration proposals would mean \$676 per unit per year in FY1984.<sup>18</sup> In other words, HUD could serve as many as 33 percent more households under the Administration's standard than it could under the House standard.

Tenant Contributions: Congress should consider raising the tenant contribution in all rent assistance programs above the current level of 30 percent of income and including the value of food stamps in computing a participant's income. The House committee, however, has voted to lower the level to 25 percent, and both the House and the Senate committees voted to exclude food stamps. Congress should also consider reducing the level of eligibility below 50 percent of local median income. Depending on the fair market rent standard adopted, this lower tenant contribution costs from \$158 to \$261 per unit per year. In other words, commitments could be increased about 10 percent if only households with this lower income level were eligible. By lowering the eligibility level to 40 percent of area median income, it has been estimated that HUD could provide housing assistance for up to 400,000 more households that are most in need.<sup>19</sup>

Workfare: Since housing assistance is a welfare program, like food stamps and AFDC, it is reasonable that workfare requirements should also be applied to people who receive housing benefits. Recipients would accept assistance knowing that they are earning their payments, while the workfare program would help them acquire the job skills and experience needed to secure permanent employment. The public also would be better served because workfare, quite properly, would discourage people at the margin who are not prepared to contribute to their own assistance. HUD statistics for 1982 indicate that 11 percent of households in public housing, and 13 percent of households in section 8 housing, participated in AFDC but contained no pre-school children.<sup>20</sup> Under current workfare guidelines, these households could be expected to perform public services in exchange for housing assistance.

#### MAKING VOUCHERS "ENTITLEMENT PROOF"

The measures described above are necessary to assure an equitable distribution of housing assistance, given present budget constraints. But as the food stamp experience demonstrates, restrictions such as these are by no means sufficient to ensure

<sup>18</sup> Correspondence with Office of Policy Research and Development, April 1983.

<sup>19</sup> Ibid.

<sup>20</sup> Correspondence, op. cit.

that a modest program does not mushroom into a major budget outlay. Congress has shown itself quite willing to rescind the eligibility criteria, as soon as it sees an opportunity to win votes.

Perhaps the only way to stop a voucher program from growing in this way is to make it a state program at the outset--with state officials having to answer for any growth in the budget. Congress should retain only oversight control and the right to set the most general standards and turn over the administration and eligibility criteria of housing assistance vouchers to the state and local governments. Each state should be provided a fixed block grant assembled from other housing assistance given to the states.

Under the block grant plan, the federal government would accept the interim responsibility of providing funds for the program and the permanent responsibility for assuring that states used the funds equitably and justly. It would also allow the states and their voters to decide who should be eligible and how the funds should be administered. It is possible that voters in some states would prefer to give large subsidies only to the very needy, while other states might prefer to give smaller subsidies to a greater number of people facing different circumstances. Voters in still other states might wish to give large subsidies to numerous households by supplementing federal funds with local funds. Whatever methods the states set up would be accountable to the voters of the state and constrained by the size of the block grant. And if state politicians succumbed to pressure to widen eligibility, they would have to find new money since federal funds would be limited to the grant.

Once such block grants were in place, and the states had tested the housing markets sufficiently to determine the best local method of administration, the federal government should begin to shift the entire financial responsibility for the program to the states. The voucher program, in other words, should be first introduced under the general management of the federal government but then transferred entirely to the states; if states chose to expand it, it would be their concern--and their budget problem.

## CONCLUSION

Senate moves to enact a housing voucher program deserve applause--at least in principle--from those who desire efficient provision of government services. It represents an important step toward focusing government housing assistance on the poor who really need it. It constitutes a major advance in the demand approach to housing. Implemented correctly, a housing voucher system would satisfy the major requirements of a government assistance program. It would provide adequate and equitable assistance to those in need at minimum cost to the government,

and it would introduce minimum distortion into the housing market. Moreover, it would give tenants maximum freedom of choice and deny developers and landlords the unreasonable federal subsidies they enjoy under the current programs.

The Senate bill, however, is seriously flawed. It plays into the hands of the big spenders in the House by busting the President's budget and by designing a voucher program in such a way that it could become a massive housing entitlement program.

If the Senate is to introduce fiscal responsibility into HUD's housing assistance programs when it goes to conference with the \$25 billion House bill, it must reduce the size of its housing authorization and modify its voucher program in the manner suggested. The present version of the housing voucher program threatens to replicate the sorry budgetary history of food stamps.

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