

# The Heritage Foundation Executive Memorandum

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## TIME FOR HUD TO HELP PEOPLE, NOT THE HOUSING INDUSTRY

As the new Congress contemplates a major overhaul of the costly and controversial housing programs managed by the Department of Housing and Urban Development (HUD), all parties to this unfolding process should recognize the extent to which existing HUD policy and the three-decade legacy of failed reforms have been driven by the business and bureaucratic interests that benefit directly from HUD's \$28 billion annual budget. Although HUD Secretary Henry Cisneros's proposals supposedly break with the past, they may do little to reduce taxpayer handouts to the housing industry. Some previous HUD Secretaries have pressed hard to end special-interest programs for the industry, only to be thwarted by the congressional leadership. But the new Congress, elected with a mandate for real reform, has the opportunity to free HUD from its industry shackles and forge a new housing policy better suited to the needs of the poor and the interests of the taxpayer.

The essential tension within U.S. housing policy is between the more traditional approach, called project-based assistance, where federal assistance is linked to a specific building and assistance to the poor first goes through developers and local housing authorities, and the newer approach, called household-based assistance, which goes directly to the tenants so that they can afford better housing. In project-based assistance, the government, operating through a local public housing authority or a non-profit organization, provides a specific housing unit to an eligible household. The unit is usually part of a larger project that was constructed or renovated with federal financial assistance: grants, low-cost loans, operating subsidies, or tax breaks to investors. Examples of project-based assistance are public housing, Section 8 new construction and substantial rehabilitation programs, and the Section 236 program. Although new commitments to these programs have been reduced since the reforms enacted under the Reagan Administration, more than 70 percent of HUD beneficiaries are still in such programs.

Numerous studies over the past three decades indicate why reformers encounter intense opposition from housing industry lobbyists whenever an attempt is made to shift money from project-based programs to household-based assistance. These studies conclude that project-based assistance is about twice as expensive as household-based assistance per household served. In addition to their high costs, project-based programs are less desirable because they segregate and concentrate the poor in specific inner-city neighborhoods, typically with high crime rates and few job opportunities. Despite their sometimes staggering costs and enormous social problems, project-based programs are strongly supported by the housing industry and such organizations as the National Association of Housing and Redevelopment Officials. The reason: these programs channel money directly to developers, rental organizations, and housing authorities.

In contrast, HUD's household-based programs provide eligible households with a certificate or voucher that can be applied to some or all of the rent for the apartment of their choice. Such apartments must meet certain minimum quality standards and are available through private landlords. Household-based programs are substantially less costly per household served. One reason for this is that landlords compete for subsidized tenants just as they must for other tenants—by offering the best price. In project-based programs they must lobby successfully for inclusion in the program, and often favoritism rather than need is the deciding factor. Household-based programs also provide households with a much wider choice of neighborhoods and allow them to be integrated into the community at large.

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Absent the intense industry pressure to maintain various forms of project-based assistance, HUD probably long ago would have shifted the bulk of its resources and beneficiaries toward a voucher and certificate-based program to reduce costs, improve the quality of life for tenants, and increase the number of households that could be assisted with the same money. But because of industry pressure and pressure from lawmakers heavily supported by the industry, HUD continues to operate grossly inefficient project-based programs. Secretary Cisneros's *Reinvention Blueprint* gives the appearance of moving toward more sensible policies. But he, too, is subject to the inexorable pull of special interests and flinches from proposing a complete reform, instead sitting on the fence.

Cisneros seems torn. Recognizing the manifest advantages of vouchers, the Secretary argues correctly in his *Blueprint* that project-based aid is a costly and wasteful way to help the poor. The *Blueprint* calls for an orderly withdrawal of federal support for public housing. It also proposes converting operating subsidies for public housing agencies to rental assistance for residents, who could stay where they were or move to apartments in the private rental market. Had this been the extent of the reinvention effort, Secretary Cisneros would be remembered for his major reform of HUD. Unfortunately, the remainder of the *Blueprint* is little more than a repackaging of the costly project-based programs and financing concessions that enrich the housing industry.

For developers, builders, and non-profit organizations, Cisneros calls for a new Affordable Housing Fund to provide federal financial assistance for the production and rehabilitation of housing. And for those in the industry who make their living in sales and finance, there is to be a new, supposedly more entrepreneurial Federal Housing Administration (FHA) "to make home ownership affordable for more first time homebuyers, residents of inner-cities and other groups and communities underserved by the private market." While the goal sounds lofty, similar efforts to extend taxpayer dollars and credits to not-yet-ready-to-own households in the past threw the once-venerable FHA into technical insolvency when it lost more than \$4 billion in one year.<sup>1</sup>

Indicative of the sorts of costly federal housing programs that members of the housing industry advocate, and their friends in Congress provide, are policies recently presented in a major housing trade association's campaign literature on behalf of one congressman running for reelection. According to the association, this congressman deserved reelection in 1994 because he favors reversing the tax code's passive loss restrictions on real estate, continuing tax-exempt Mortgage Revenue Bonds, retaining tax credits for investors in low-income housing, and increasing FHA loan limits and loan-to-value ratios. Each of these measures directly benefits Americans whose incomes are high enough to need tax shelters or who can afford higher-cost homes.

Such industry-supported housing assistance programs provide direct benefits largely to well-to-do Americans in the hope that their actions will lead to indirect benefits for the poor. Such trickle-down welfare programs are highly inefficient and wasteful because only a fraction of the taxpayers' money actually goes to the poor. The remainder goes to those who purport to help the poor—such as investors seeking tax shelters and developers.

The key to an effective and efficient housing program is to reduce the "wedge" driven between what the program costs the taxpayer and what the intended beneficiary ultimately receives. The project-based programs favored by the housing industry lead to inefficient policies in which the costs to taxpayers are substantially higher than the benefits ultimately received by assisted households. It is time for Congress to enact real reform at HUD by ending programs that make the Department little more than a lottery for some real estate developers, builders, and agents.<sup>2</sup>

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1 Ronald D. Utt, "Limiting the Damage from the Federal Housing Administration Collapse," Heritage Foundation *Background Update* No. 115, October 12, 1989.

2 The Heritage Foundation shortly will release recommendations on how America's housing policy can serve more disadvantaged households at lower costs than at present.