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THE "SAFETY NET" AFTER THREE YEARS: INCOME MAINTENANCE AND REDISTRIBUTION PROGRAMS IN THE REAGAN ADMINISTRATION

HOUSING

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40th year

INTRODUCTION

When the Reagan Administration came into office, it was confronted by rapidly-rising costs in the low-income housing subsidy programs, and the programs themselves were widely regarded as defective on both equity and efficiency grounds. The Administration quickly began to restrain the rate of cost increase in these programs, while it developed an alternative approach that was potentially a fundamental redirection of housing policy. In these efforts it has been fairly successful--more in the area of cost-cutting than with the new policy--but at the end of 1983 Congress approved a new housing bill which suggests that the Administration has passed the high tide of its success, and is beginning to lose ground.

The substantive policy proposals are generally consistent with the recommendations of housing economists in both parties.[1] But the Administration has received less credit for them than might be expected. The rather unfavorable tone of public discussion appears to stem from three causes: it is not adding to the stock of subsidized housing fast enough; some of its cost-cutting measures fall on the subsidy recipients, and thus are considered inequitable; and it has proposed a few program changes which are controversial out of all proportion to their real importance.

After a short review of the development of housing policy, the paper describes the Section 8 programs, which are the largest programs in terms of total units, additional units each year, and budget. It then discusses the subsidies for continued operation of public housing projects. Finally it addresses more briefly the "symbolic" issues. The focus is restricted to the low-income programs operated by the

Department of Housing and Urban Development. The paper ignores the programs of the Farmers Home Administration, the mortgage insurance programs of the Federal Housing Administration and the Veterans Administration, and Urban Development Action Grants.

SECTION 8

Historical Background

From the beginning, federal housing policy has been to build new apartments in projects which are specifically designated for the poor.[2] This reflected the widespread belief that the existing housing stock, particularly that part of it available to the poor, was seriously substandard, and could not easily be upgraded. Subsidized housing was also seen as a way of stimulating the economy, particularly in the Depression; public housing was part of public works. The macroeconomic purpose has been deemphasized as evidence accumulates that subsidized construction is an ineffective countercyclical policy tool, but it has an important lingering effect; housing program activity is usually measured in terms of additional units subsidized each year, rather than the total number of assisted households or individuals. Other income redistribution programs are seldom evaluated on this incremental basis.

The first subsidized production program, public housing, began in 1937 and has continued ever since, though it has been through several cycles in popularity and activity. It was essentially the only subsidized program for a quarter-century. But since 1961, there have been three successive major new programs, intended either to substitute for public housing or to supplement it: Section 221 in

1961, Sections 235 and 236 in 1968, and Section 8 in 1974.[3] Each of these has proven unsatisfactory in turn, and been superseded. Thus there has been continuing political controversy about housing, perhaps on a more extensive scale than in other income redistribution programs; certainly none have been more frequently redesigned.

All of these programs continued to subsidize new construction projects. However, the postwar period saw a marked and steady improvement in the quality of the existing housing stock, and a rapid reduction in the number of substandard housing units--partly through demolition, but also through upgrading. This fact gradually began to affect housing policy. In the mid-1960s public housing was extended to the existing housing stock in the Section 23 Leased Housing program. Local authorities could sign leases with private landlords, and the federal government would make the same subsidy payments as for new apartments. The program was not large, but it was the forerunner of Section 8, in which subsidies have been provided for both new projects and existing houses and apartments.

The general housing quality improvement also led to an extensive experiment with "housing allowances," in which low-income households were given vouchers, commitments from the federal government to make payments for housing which the households found for themselves in the private housing market. The Experimental Housing Allowance Program (EHAP) began in 1973 and continued until 1980; it is probably the largest social experiment ever conducted by the federal government.[4] Throughout the 1970s, there was increasing discussion of whether housing policy should continue to adhere to the traditional approach of building apartment projects, or whether primary reliance should be placed on the existing privately-owned inventory as the source of housing for the poor. The actions of the Reagan Administration can be seen as the latest chapter in this debate.

<u>Program Description</u>

When President Reagan took office, there were two quite distinct subsidy programs--one for new construction projects, the other for existing housing--which were both known as Section 8, because they had both been created in Section 8 of the Housing and Community Development Act of 1974. Some of the differences between Section 8 New Construction and Section 8 Existing Housing are important for the understanding of recent housing policy. In particular, they have different subsidy mechanisms, and dramatically different costs.

In the existing housing program, a subsidy commitment is given directly to the family, which then selects its own housing, subject to minimum quality standards and a maximum rent, as established by HUD (the "Fair Market Rent" or FMR). The family pays a specified percentage of its income toward the rent, with the government paying the remainder. The subsidy is tied to the family; if it moves, it retains the subsidy in its new house or apartment, subject again to the quality standards and rent ceiling.

For new (and also substantially rehabilitated) housing, the subsidy is tied to the unit. HUD selects projects from among proposals by private developers, non-profit sponsors, and state housing finance agencies, and promises to subsidize low-income tenants who occupy the apartments in these projects. If the tenants move, they no longer receive the subsidy; the new tenant does.

Program costs differed for two reasons. First, the monthly subsidy per unit has been much higher in the new construction program. Both established the same household income limits to be eligible for subsidy, and the same maximum rent/income ratios for tenants. But they did not set the same Fair Market Rent. The FMR in existing housing was based on the distribution of rents actually paid in the private market for standard-quality housing. The new construction FMR was based on rents for recently built unsubsidized apartment projects. These were supposed to be equivalent in quality, but in fact the new private projects are typically much better than the average existing rental apartment. In addition, a variety of adjustments were added to compensate for special factors which raised construction or financing costs. Thus, indirectly if not officially, the new construction FMRs were based on the cost of construction, rather than the actual market rental of modest, decent housing, and were substantially higher than the existing housing FMRs, even though both were supposed to be measuring the same concepts.[5]

The federal government also undertook to subsidize new projects for a longer period. Commitments ranged from 20 to 40 years, depending on the nature of the developer and the character of the project, in order to enable the developer to issue a long-term mortgage with a guaranteed income stream. In the existing housing program, the commitment ran for only 15 years. Because the full amount of the commitment is authorized in the budget for the fiscal year in which it is made, the budget authority for each new construction unit is much larger than for existing housing.[6]

Program Growth

Between its inception in 1974 and the election of 1980, Section 8 grew rapidly. At the end of FY 1980, over 1.1 million units were in the program, almost as many as in public housing (1.2 million), after more than 40 years, and more than the 900,000 units in all of the other subsidy programs combined. Two-thirds of the Section 8 units were existing housing. Including new public housing units, this represented a 50 percent growth in the total number of subsidized housing units in just six years.

Costs were also rising, particularly in the new construction program. In 1976, for example, the budgeted subsidy for each new construction unit was $3,300 annually, or $275 per month; for existing housing, it was $1,800 annually, or $150 per month. For FY 1981, beginning in October, 1980, costs were budgeted at about $5,400 for new units, or $450 per month, and $3,000 for existing, or $250. The per-unit cost of new construction was about 50 percent more than the typical rent for a new private apartment, and almost double the median rent for all units in the private market.[7]

The total budget authority approved by Congress did not rise as rapidly. After an abrupt increase from $18 billion in 1976 to $28 billion in 1977, it fluctuated only slightly around that level over the next three years.[8] This meant that fewer additional units could be subsidized each year. This problem was further exacerbated by increasing emphasis on new construction. During the first two years of the program, the Ford Administration had favored utilizing the existing stock, and just over 60 percent of the units approved for subsidy ("reserved") were existing. By 1980, the Carter

Administration had shifted this to 63 percent new construction (or substantial rehabilitation, which was even costlier). In addition, per-unit costs were consistently underestimated, so that fewer units could be financed with each year's budget authority than originally planned. For all these reasons, the total number of newly subsidized units dropped from 400,000 annually in FY1977 to 206,000 in FY1980.

The 1980 budget was the first to present explicitly the per-unit annual and total budget outlays for each program category within Section 8. For FY1981, the budget authority for each new construction unit was almost three times as large, $123,000 vs. $45,000 for existing housing. The contract authority, the maximum annual amount which the government will spend per unit, was almost double, $5,400 vs. $3,000; and the average term of the contract was half again as long, about 23 years vs. 15. Because of the long-term financial commitment, the total federal budget obligation for Section 8 amounted to $130 billion over the next 30 years, of which two-thirds was for new construction, although there were far more existing housing units receiving subsidies. In addition, some $71 billion was obligated for public housing projects, and $45 billion for other low-income housing programs, for a total of $250 billion. In 1975, by contrast, the total long-term budget obligation was less than $90 billion.

It seems clear that, at the beginning of 1981, dissatisfaction with Section 8 New Construction was sufficiently widespread that the program would have been terminated or drastically modified regardless of the outcome of the election, primarily if not exclusively because of its cost. For the fourth time in 20 years, the federal government, including both Congress and the Administration, were seeking a new way to provide housing assistance for the poor.

Short-Run Goals: Reducing Program Costs

The Reagan Administration initially focussed on the cost of Section 8 New Construction, while it considered alternative policy approaches.

During 1980, Congress approved $27.3 billion for subsidized housing for FY1981, to fund about 255,000 additional units, split 55/45 between new and existing (140,000 vs.115,000). President Reagan submitted a rescission of $4.7 of this authority as part of his revision of the Carter budget for FY 1982. This reduced the number of additional subsidized units to 210,000, split 49/51 between new and existing (103,000 vs. 107,000). Congress approved the rescission.

For FY 1982, President Carter wanted $27.6 in budget authority for 260,000 additional units, split 50/50. President Reagan asked for another rescission of $9.4 billion, cutting the number of additional assisted units to 175,000, split 45/55 (79,000 vs. 96,000). This rescission also passed, but, with later changes, the actual number of reservations turned out to be only 145,000, split 28/72 (40,000 vs. 105,000).

These figures overstate the change in the total number of units receiving subsidies from the federal government, because they include units which are transferred from older subsidy programs to the Section 8 Existing Housing Program. These are treated as additional Section 8 units in the budget. President Carter proposed to transfer 23,000 units from the Rent Supplement Program to Section 8 in his FY 1981 budget, and Congress approved 10,000; in FY1982 he proposed a further 20,000 conversions. President Reagan did not originally ask for any changes in these figures, but in his FY1983 budget proposed to convert the entire program (195,000 units) to Section 8 over the next three years, beginning in FY1982. Congress approved this as part of the Urgent Supplemental Appropriations Act of 1982. The total number of conversions budgeted for the two years therefore was about 79,000.

Thus, for the first two fiscal years of his term, President Reagan achieved a $14 billion cut in budget authority for additional units, about 25 percent; a reduction in the number of assisted units of about 160,000; and a much greater cut in new construction (127,000) than in existing housing (33,000). Taking conversions into account, President Reagan cut about 210,000 units, 60 percent of them new. These are large numbers.

But at the same time that it cut the number of additional subsidized units, the Administration was willing to raise the per-unit subsidy on those that it assisted. Conversion from Rent Supplement to Section 8 was accompanied by an increase of about $1,000 in the annual subsidy, two-thirds more than the $1,500 in the older program.

Similarly, while it sharply cut the number of new Section 8 units, the Reagan Administration institutionalized a mechanism for increasing the subsidies for those which were approved. It permitted new construction FMRs to be increased because interest rates were unusually high. The FMRs could be calculated on the basis of a 12 percent mortgage rate, rather than eight percent. This financing adjustment factor (FAF), first utilized by the Carter Administration in 1980, further reduces the relationship between actual market rents and the subsidy payments under the new construction program.

It should also be stressed that these large budgetary changes only represent reductions in the number of additional housing units to be subsidized, not reductions in the total number of subsidized units, or in the number of households being subsidized. That number actually grew by about 400,000 between FY1980 and FY1982.

None of the budget changes so far discussed had any impact, favorable or adverse, on the households actually being subsidized when President Reagan took office. The new Administration did, however, propose several such changes. The most important was an increase in the maximum rent/income ratio for tenants from 25 to 30 percent. This was approved by Congress, subject to a limitation that no tenant's rent could be increased by more than 10 percent in a year, and the Administration began to phase it in, one percentage point per year, beginning in FY 1982. In addition, new tenants were required to pay 30 percent immediately. A second technical change required local housing authorities to adopt the same standards for determining tenant income. The previous system allowed discretion and resulted in horizontal inequities--households with the same income received different subsidies in different place. At the same time, the Administration wanted to target subsidies more precisely to the poorest households, by limiting the number of "moderate-income" households (those with incomes between 50 and 80 percent of the local median). These proposals were also approved by Congress in 1981.

The significance of all these changes is that, although they did not constitute a fundamental redirection of housing policy, they did move the Section 8 program toward a much greater reliance on utilization of the existing housing stock, whether on ideological grounds or merely from a desire to reduce the budget. They thus set the stage for a more important program change, which was formulated in the Administration's FY1983 budget.

Long-Run Goals: Using Existing Housing

The new proposals had two major features: they virtually ended new subsidized housing production, terminating both Section 8 and conventional public housing; and they modified the Section 8 Existing Housing program to provide more freedom of choice for assisted tenants, moving the program in the direction of a housing allowance, with less government involvement in the decision of the household. They also sought to reduce the budget impact of subsidized housing.

The most important modification allowed subsidy recipients--housing certificate holders--to select housing that rents for more than the FMR (or "payment standard," in the new terminology of the proposal), if it wishes to spend more than 30 percent of its income for housing. It also gives the certificate holder an incentive to shop for the best bargain, by allowing him or her to keep any difference between the payment standard and the actual rent; in the original Section 8 program, households kept only part of the saving, and even this incentive was later eliminated. The proposed changes were features of the housing allowance experiments which had proved successful.

But in other important respects, the program was unchanged from Section 8 Existing Housing. The minimum quality requirement was retained; subsidized households were not free to choose substandard housing. And the subsidy was to be paid by the local housing authority to the landlord, once the unit had been approved and the lease signed, rather than to the tenant. This meant that the landlord would automatically know that the tenant was being subsidized. Thus the Administration's name for the new program--Modified Section 8 Housing Certificate Program--seemed entirely appropriate, although it was widely but erroneously termed a "voucher" program.

By themselves, these changes would not result in budgetary savings; indeed, they would if anything increase program costs, by permitting households to keep any difference between the payment standard and the rent. But the Administration also tried to cut the per-unit cost in several ways. First, it proposed to reduce the payment standard from the 50th percentile of the rent distribution to the 45th percentile. Second, it wanted to include the value of Food Stamps in tenant income. Third, it asked Congress to allow annual rent increases of up to 20 percent. In the aggregate, these changes were expected to hold the average annual subsidy to $2,000, compared to a budgeted $3,600 for Section 8 Existing Housing in the previous fiscal year.

The program would also be targetted more narrowly. Only families with incomes below 50 percent of the local median would be eligible.

In addition, the Administration proposed to reduce the term of the budget authority per unit from 15 to five years. This change by itself would cut the amount of authority by two-thirds. It would not, however, necessarily lower long-term program costs. Instead, it would require more frequent authorizations to continue subsidizing the same number of households. Its most important effects might be to compel future Administrations and Congresses to reconsider housing programs regularly, to minimize the costs of unanticipated and undesirable program outcomes, and to provide more flexibility to change programs.

The total budgeted cost of the program was more of a departure from the past, and more controversial politically. The Administration proposed to provide certificates for only about 122,000 units, all but 10,000 of them existing housing. This was about the same number as in each of the two preceding years. However, about 61,000 of these were to be used to convert units already in the Section 8 Existing Housing program to the modified program; with other conversions, there would be only a net increase of 55,000 assisted units, 45,000 of them existing housing.

Even more startling was the total dollar amount of the program-- $7.5 billion. This was less than half the figure for FY 1982, and less than a third of that for FY1980. Moreover, the Administration sought no new budget authority for additional subsidized housing units. Instead, it proposed to fund the entire amount needed out of recaptured funds from previously-approved Section 8 New Construction and public housing projects which the developer had subsequently decided not to build. Recaptures have not been uncommon; in FY1981, for example, they amounted to $5.3 billion, for 42,000 units. But in the past, the funds have been recommitted to other projects. HUD now projected recapture of $9.9 billion in FY1983, proposed to use $7.5 billion of it for the new Modified Certificate program, and submitted a rescission for the remaining $2.4 billion. For good measure, it also asked for a rescission of the $7.5 billion that it expected to recapture in FY1982, and an additional $2.4 million, virtually eliminating new construction from the FY1982 budget.

The magnitude of these fiscal changes has obscured the fact that the substantive differences between the original Section 8 Existing Housing program, and the Modified Certificate program, are not actually very great. In addition, some of the smaller components of the Administration's program further reduce the extent of the change. For example, the budget contained a new proposed Rental Rehabilitation Grant, which would give $150 million to states and local governments for the rehabilitation of 30,000 rental houses and small apartment buildings. These units would also receive Section 8 certificates, so that in effect the government would guarantee the rent for five years, in addition to paying for the rehabilitation. This explicit double subsidy is something new in low-income housing programs, although it was implicit in the Section 8 rehabilitation programs developed by the Carter Administration. Further, as in the new construction programs, the rental subsidy was tied to the unit, not the family.

The budget also continued one new construction program, Section 202, which provides for direct loans from the Treasury, at a below-market interest rate, to nonprofit sponsors (usually religious groups) of housing projects for the elderly. The program was established in 1959; since 1970 it has been used in conjunction with other subsidy programs, because the interest rate reduction is not large enough to bring the rents within reach of the low-income elderly. In the late 1970s, this program averaged about 20,000 additional units annually, all in conjunction with Section 8. The Administration cut this to 10,000 in the FY1983 budget, but did not propose to end the program.

Congressional Action

In essence, the Administration's proposal was accepted in the Senate but rejected in the House. The deadlock continued throughout 1982, until the post-election session, when a continuing spending resolution provided $13.1 billion for some 173,000 subsidized housing units, 65,000 conversions and 108,000 additional units. Of these, only about 16,000--less than 10 percent--were new construction (14,000 Section 202 and 2,000 public housing units on Indian reservations. The remainder were Section 8 Existing Housing. No funds were provided for conventional public housing or Section 8 New Construction. The Administration thereby achieved one major goal--virtual elimination of new construction. However, the program modifications for Section 8 Existing Housing were not approved, nor was the rental rehabilitation grant. Moreover, the program was larger than the Administration had asked for, by some 50,000 units, and Congress approved an additional $6.1 billion in budget authority to finance it. (Separately, Congress approved a rescission of $4.1 billion for FY1982, instead of the $9.4 billion requested by the Administration.) The amount of recaptured authority was projected as $4.6 billion, instead of $9.9 billion.

Recaptured authority became an important issue during 1982. HUD's regulations have limited the period of time allowed between the reservation and the start of construction on a project, but the limits have traditionally not been enforced. HUD wanted to stop granting extensions for projects exceeding the time limits, which would have enabled it to recapture the budget authority. Neither the developers, the local housing authorities, nor Congress favored this. Instead, Congress directed HUD to make every effort to expedite construction of the units already in the "pipeline." As part of this effort, the financing adjustment factor was increased; Section 8 New Construction FMRs could now be set on the basis of a 14 percent mortgage rate. Some $655 million in budget authority was also mandated to pay higher interest rates on public housing bonds. The per-unit cost of subsidized new construction continued to rise.

1984 Proposals

For FY1984, the Administration essentially resubmitted its 1983 proposal, with only minor substantive modifications, and a minor name change--it was now the Housing Payment Certificate program. The main difference was that the annual subsidy amount could increase as market rents rose, or household income fell, during the five-year term of the certificate. Again it proposed to fund the program without new budget authority, projecting more in recaptures ($4.4 billion) and deferrals from FY1983 ($3.1 billion) than the cost of the program ($6.5 billion). The total number of assisted units was about 130,000, of which 10,000 were again Section 202 new construction, 40,000 were conversions, and 80,000 were units not previously subsidized. The rental rehabilitation grant was again proposed for 30,000 of the additional units. The total was almost exactly the same as in 1983, but the number of incremental units, excluding conversions, was 35,000 more. Per-unit costs for the certificates were projected at $2,000.

But this year the Administration has been less successful. In midyear Congress passed an appropriation bill, providing $8.4 billion for 100,000 additional units, of which 16,000 would be new Section 202 or Indian public housing units, and 45,000 would be Section 8 Existing. But it also set aside $1.5 billion for another 38,000 units, to be subsidized under whatever new program might subsequently be enacted. The projected recapture amount was cut to $2.5 billion; $5.9 billion was new budget authority.

At the end of its 1983 session, Congress created a new subsidized construction program. This multifamily grant differs from past subsidies in that the federal government will make direct grants to the local housing authority, rather than making the payments on long-term bonds. It will therefore require much less budget authority per unit. It is a small program--$615 million over two years--which may fund about 10,000 new construction or substantial rehabilitation units, and 30,000 moderate rehabilitation units each year. In addition, housing certificates will be tied to about half of the latter, as a "demonstration" of the certificate program. The net effect is that Congress has not in fact approved the Housing Payment Certificate program, but it has approved the rental rehabilitation grant, and called it a Housing Payment Certificate.

The bill is a partial success for the Administration. It does accept the proposal to lower the FMR for existing units. And it halts new public housing projects, at least while the pipeline is cleaned out, and terminates altogether the statutory authority for Section 8 New Construction even as it creates another new construction program. It is somewhat larger than the Adminstration's budget request, more in terms of new authority than additional assisted units, though not dramatically higher. But it does not contain the major program changes sought by the Administration.

For FY1985, it appears that the Adminstration is going to try again for the same program, at about the same unit and budget levels.[9]

PUBLIC HOUSING

Besides controlling the growth in the total number of subsidized housing units, and the cost of the additional units, the Reagan Administration has also sought to restrain the rise in outlays for units subsidized under the older programs, primarily public housing.

Operating Subsidies

When public housing was started in 1937, the financial arrangements were straightforward. The federal government paid the cost of building the units, making principal and interest payments on tax-exempt bonds issued by local public housing authorities; the tenants made monthly rental payments, which were expected to cover the operating costs of the project, such as utilities and maintenance. Rents were also limited by statute to 20 percent of tenants' incomes (with various adjustments). This meant that the very poorest households were effectively excluded from public housing, since their incomes were not large enough to meet the operating costs. In 1959 the law was changed to allow local authorities to set their own income limits and rents. Initially, most continued to set rents high enough to cover operating costs. But after about 1965, operating costs began rising more rapidly than tenant incomes, chiefly as a result of the general inflation suffered by the economy.

Congress reacted by limiting the tenant's rent to 25 percent of income, even if this was less than the operating costs of the unit. This made public housing affordable for the poorest households, and as a result the program began to serve an increasingly lower-income clientele.[10] It also necessitated a further federal subsidy to cover the difference between operating costs and tenant rents. And it removed the financial constraint on operating expenses that had been effectively imposed by the tenants' rental payments.

Operating subsidies began in 1969 and grew rapidly.[11] In the first year, outlays were $12.6 million, less than $1.50 per month for each public housing unit. By FY1974, they had increased fifteenfold, to $276 million or over $20 per unit month, and some analysts were beginning to speak of the "financial crisis" in public housing resulting from the rapid rise in operating costs.[12] Both the Office of Management and Budget, and Congress, were increasingly concerned, and insisted that HUD find some way to determine the appropriate level of operating subsidies, which would encourage local authorities to manage projects more effectively and economically. In 1975 HUD therefore adopted the Performance Funding System (PFS), which is based on a statistical analysis of the operating costs of well-run projects, relating their expenses to certain project characteristics (such as unit size, structure type, and location). The analysis is then used to estimate the operating costs that any project should incur, if it were well-run, and the operating subsidy provided by the HUD is the difference between this estimated level and the rents paid by tenants.

However, the Performance Funding System was insufficient to restrain the growth of operating subsidies, in the face of rapidly rising utility costs, particularly for fuel oil, and slowly rising tenant incomes. From FY 1974 to FY 1977, operating subsidies approximately doubled, to $522 million or about $37 per unit month; from FY 1977 to FY 1980, they rose again by half, to $862 million or about $60 per unit month. Operating subsidies had also risen dramatically as a share of total operating costs, from 3 percent in 1969 to 30 percent by 1974, 35 percent by 1977, and almost 40 percent by 1980. At the same time, total operating costs more than tripled.[13]

The increase exceeded the growth in operating costs for private housing. Much of it was due to the rise in energy costs after the

1973 oil embargo, but public housing utility outlays increased more rapidly than the Consumer Price Index utility component. An important difference between public and private housing has been that tenants in the former have no incentive to conserve on energy, because their rents cannot rise when their utility consumption does. HUD has attempted to meet this problem by paying for only 75 percent of any increase in consumption, and by permitting the local authorities to keep 25 percent of any savings in operating subsidies resulting from reduced consumption. It also has been providing funds through its modernization program (discussed in the next section) for energy conservation equipment such as meters for individual units.

Despite this rapid increase, some public housing analysts were concerned that the PFS was increasingly underestimating the growth of operating costs and therefore providing an inadequate level of funding. This is because the formula was being adjusted annually for inflation in utility costs and local government employee wages (the latter representing maintenance and all other non-utility operating costs). The adjustment therefore omitted changes in the cost of physical maintenance inputs. A study undertaken for HUD in 1979 concluded that the omission seriously understated the inflation rate for operating costs. In addition, operating subsidies are funded in advance, and therefore the expected rate of inflation is used to estimate them in each year's federal budget. In the late 1970s, inflation was consistently underestimated, so that local housing authorities were faced with a real decline in operating funds, relative to actual costs.[14]

As President Reagan came into office, operating subsidies were rising at an accelerating rate. For FY 1981 the Carter Administration had received an appropriation of $862 million, or about $61 per unit month, and was asking for a supplemental appropriation of $100 million (about $7 per unit month) to meet rising utility costs. In addition, the Carter budget for FY 1982 incorporated a retrospective inflation adjustment for non-labor operating cost increases, as recommended by the 1979 HUD study. The total request for FY1982 was $1.265 billion, or over $85 per unit month. This was an increase of $400 million in two years, over 35 percent for each individual unit.

The Reagan Administration retained the inflation adjustment in its revision of the 1982 budget, thus accepting a large increase in operating subsidies. However, it sought to restrain their growth in other ways. It withdrew the supplemental request for FY 1981, on the basis that the higher utility costs should be funded out of the separate Low-Income Energy Assistance Program, which was receiving a $250 million funding increase. It also asked for the same structural changes as in Section 8. Congress passed the supplemental anyway, but also approved the per-household maximum subsidy changes, subject to the limitation that no tenant's rent could rise by more than 10 percent in a year. The one percentage point increase in the tenant rent/income ratio for FY1982 cut operating subsidies by $60 million.

For FY1983, the Administration proposed further changes, much like those in Section 8. It wanted to count Food Stamps as income for tenants. To restrain utility cost increases and give tenants the incentive to conserve energy, it sought to require them to pay any utility costs in excess of 25 percent of income. Because these changes might increase rents for some tenants by more than 10 percent, it also asked that the annual ceiling on increases be raised to 20 percent. Finally, it proposed a reduction in operating subsidies to $1.075 billion, or $72 per unit month, partly to reflect these changes and partly on the ground that modernization of the older units would achieve significant energy conservation. Congress rejected all these changes and voted operating subsidies of $1.350 billion, or $92 per unit month, implicitly also rejecting the argument that modernization expenditures in the past had resulted in energy conservation.

After two years of these relatively minor modifications to the existing operating subsidies program, the Administration proposed a new and radically different program for FY 1984. The new system utilized the same Fair Market Rent concept as Section 8. Operating subsidies would be based on the rents charged for private housing, not the costs of operating public housing. The public housing FMR would be set at the 40th percentile (rather than the 45th) of the rent distribution for private, standard-quality housing that was at least two years old. The tenant's rent, and the cost of debt service on the public housing bonds, would be subtracted from the FMR to determine the operating subsidy. The proposal also incorporated the Food Stamp and 20 percent rent increase ceiling from FY1983. This plan would have lowered the operating subsidies for some units, and raised them for others; however, the latter units would get only the same amount that as under the PFS, rather than the FMR-based subsidy. This meant that some units, and some authorities, would have received smaller subsidies than under the old system, and none would have received larger ones. HUD has estimated that about five percent of all PHAs, managing five percent of all units, would have faced reductions of 10 percent in their operating subsidies; the reductions would have been limited to five percent annually.

Under the FMR system, operating subsidies would total $1.330 billion in FY 1984, or $90 per unit month.[15] This compares to $105 per unit month under the PFS. In future years, subsidies would remain about 15 to 17 percent below those projected under the old system. They would, however, continue to rise; the projected 1988 FMR-based operating subsidy was $112 per unit month.[16]

This proposal attracted favorable comment among some advocates of public housing,[17] but received short shrift in Congress. The midyear appropriation bill contained $1.4 billion for operating subsidies, the full amount projected under the PFS, and the yearend authorization very nearly legislated the continued use of the PFS, which had been adopted by HUD administratively. And instead of enacting the proposed changes in income and rent limits, the House wanted to roll back the maximum rent/income ratio to 25 percent; the final bill retained the 30 percent ratio, but raised the amounts to be deducted from income before it is calculated. The higher deductions mean that about a quarter of the 1981 rent increases have effectively been repealed, more for the lowest-income tenants.

Preliminary indications are that the Administration will abandon the FMR-based system in its FY1985 budget proposal, and will revert to the PFS, perhaps modified.[18] Thus the Administration's attempts to reform the system fundamentally have been unsuccessful; its efforts to restrain the growth of operating subsidies have fared better, but the savings are fairly small--probably less than $15 per unit month--and have come under increasing attack.

Modernization

Since 1968 the federal government has also provided subsidies for the modernization of older, deteriorating or obsolescent public housing projects. Modernization funds are supposed to be used for major repairs or alterations that extent the life of the project and may therefore legitimately be regarded as capital outlays. Priority is also given to energy conservation and to changes necessitated by federal, state or local laws, such as making projects accessible to the handicapped or removing lead-based paint from interior walls.

There are several recognized problems with the modernization program. The money should not be used for normal maintenance, which is supposed to be financed out of operating revenues (including federal operating subsidies), but it often is used for repairs that have become necessary because maintenance was deferred in the past. Indeed, local public housing authorities have an incentive to delay maintenance until modernization money is available. For this reason, some analysts and advocates of public housing have recommended that operating subsidies and modernization funds be combined.[19] This would confront public housing managers with the same incentives to allocate funds between short-term maintenance and long-term major repairs that private landlords face.

A second problem is that funds are appropriated by Congress annually, and then allocated by HUD to local authorities at its own discretion. Large year-to-year fluctuations have been common for any individual housing authority. This means that local authorities have trouble planning and conducting their repair programs on any long-term comprehensive basis.[20]

Modernization is financed through the same mechanism as project construction. The local authorities issue bonds, on which the federal government provides the funds to make principal and interest payments over a 20-year amortization period. Each year's budget contains an appropriation for the full 20 year term of the bonds to be issued in that year. Through fiscal year 1980, about $6.6 billion in bonds had been issued, to finance about $3.6 billion worth of modernization.

The program has been growing rapidly, if somewhat erratically, since it was started. It grew particularly rapidly in the Carter Administration. In the early 1970s, about $250 million worth of modernization was financed each year: by FY1977, the last year of the Ford Administration, this figure had risen to $324 million; by FY1981, the program had nearly tripled in four years, to $927 million.

But this has not been enough to fully modernize public housing. A 1979 study conducted for HUD estimated the total "catch-up" modernization cost at $250 million to bring all projects up to basic health and safety standards; $1.5 billion to meet HUD's Minimum Property Standards for FHA-insured apartment projects; and $6.8 billion to make public housing competitive with private rental housing.[21]

Thus the Reagan Administration came into office confronting another rapidly-growing program which was not effectively fulfilling its purpose, and which was widely regarded as having significant structural and administrative flaws.

Here too its initial efforts were devoted to reining in the growth of the program. For FY1981, Congress had appropriated $2 billion in budget authority, enough to support about $1.1 billion worth of modernization, and for FY1982, President Carter asked for the same amount. President Reagan sought and received a rescission of $300 million of the FY1981 appropriation, which still left it 70 percent above that for 1980. He also cut the 1982 budget request to $1.5 billion, but Congress appropriated $1.8 billion. For FY 1983, the Administration asked for the 1982 amount again, $1.8 billion; Congress appropriated $2.5 billion. In these three years, the Administration has asked for over $2.5 billion worth of modernization, and Congress has funded just over $3 billion, almost as much in current dollars as in the first 12 years of the program altogether.

In its 1984 budget, the Administration sought major structural reform. It wanted to combine operating subsidies and modernization funds, and it also proposed a new "transition modernization" program to bring all public housing projects up to the Minimum Property Standards. The transition program was proposed to cover a four-year period, through FY1987. The combination of funds would permit local authorities to make their own decisions as to the proper maintenance strategies for their projects, and significantly reduce HUD's day-to-day involvement in the management of public housing. Thus the plan addressed the major conceptual problems in the current system.

The new modernization "replacement allowance" was set at 20 percent of estimated non-utility operating costs. For FY1984, this was budgeted at $340 million. In addition, $687 million worth of transition modernization would be financed by a $1.4 billion appropriation for 20-year bonds. The total of $1.027 billion would be about $250 million less than in 1983, but above any preceding year.

However, total modernization funds were projected to decline steadily until 1988, as the transition modernizaton program was phased out, while the replacement allowance increased gradually to $437 million.

These numbers have been questioned. The Congressional Budget Office has noted that the 20 percent replacement allowance is based on one year's experience of private rental projects, and may therefore be an inadequate guide to long-term public housing needs; it has costed out an alternative which is about 20 percent more expensive.[22]

The transition modernization program would amount to $1.7 billion worth of repairs in four years, or about $1.1 billion in 1980 dollars. This represents about two-thirds of the "catch-up" modernization needs estimated in HUD's 1980 study. The Administration program assumed that the worst 100,000 public housing units are withdrawn from the stock, which accounts for much of the difference. This is about the number identified in the 1979 study as being "distressed."

The Administration proposal also assumed that recent modernization funding has not been spent on badly deteriorated units, and that no further deterioration has occurred since 1980. The latter seems a reasonable assumption on its face, given the $2.5 billion in new modernization that has since been authorized; if that has not been enough to halt deterioration, on the average for the public housing stock if not for each individual unit, then one must wonder about the initial construction quality, the competence of project management, or the administration of the modernization program. So large a sum should be adequate even if some of the money has been spent on projects which would be eliminated under the new proposal. But Congress has questioned whether it really is enough, and has mandated that HUD spend $4 million to repeat and update the 1979 study.

Congress did not approve these changes, any more than the new operating subsidy mechanism. There was support in the Senate for a more expensive replacement allowance, similar to that analyzed by CBO, but the housing appropriation bill continued the present system, at a funding level of $1.6 billion. For FY1985, HUD is reported to be asking again for a replacement allowance and separate modernization funds along with the return to the Performance Funding System approach to operating subsidies. It is too early to know whether this will amount to a resubmission of last year's proposal, conceptually, or whether the Administration will withdraw its 1984 approach rather than attempt to persuade Congress to accept it. It seems likely that the FY 1985 budget will propose a more expensive program, in either event.

SYMBOLIC ISSUES

The level of subsidized housing production, and the cost of operating and maintaining public housing, have been the most important substantive and budget issues facing the Administration. But there have been other questions, more symbolic than real, which have arisen, and which contribute to the impression that the Administration is unsympathetic to the poor, or "anti-housing."

One of these is whether the Administration wants to "get rid" of public housing. In the last two budgets, as part of the modified Section 8 program, the Administration has stated that it proposes to set aside funds ($10 million) for tenants of 5,000 public housing units, when the projects are sold or demolished. And in FY1984, as noted, it has proposed a modernization budget that anticipates the demolitions of the worst 100,000 public housing units, which--

according to the 1979 study--would cost about $10,000 per unit in current dollars to bring up to minimum property standards. This would seem to be a reasonable decision. But public housing remains an emotional issue, even after 45 years, and these possibilities upset public housing advocates and local housing authorities. They bring back vivid memories of the demolition of the Pruitt-Igoe project in St. Louis in 1972, which has probably contributed more to the negative image of public housing than anything else.

They also heighten the intensity of the debate over recaptures and the pipeline, raising suspicions that the Administration is trying to stop projects that really could be built, if it were willing to try. Meanwhile, the pipeline is being reduced. The number of reserved, not started units has been declining, from 290,000 at the end of FY1980 to 166,000 at the end of FY1982. A small part of this decline results from actual recaptures, about 22,000 units in FY1982; the rest has occurred because construction starts from past commitments have greatly exceeded new reservations. About half of the remaining units in the pipeline were approved before 1981, and have taken at least three years, so far, without reaching the ground-breaking stage; they would seem to be reasonable candidates for recapture. The Administration has projected some 57,000 in the next two years, less than the number of these older units. But the discussion is complicated by the spectre that recapture is part of a plan to "do in" public housing, raised by the Administration's occasional discussions and limited proposals to demolish or sell some public housing units. If there is more than symbolic importance here, it is hard to see; at the proposed rate of demolition, the last public housing unit would be razed in the year 2244.

Another symbolic issue has arisen in the Community Development Block Grant program. The Administration has proposed to reduce the requirements that CDBG be targetted to low- and moderate-income households, requiring instead only that they meet any one of three objectives, including the income criterion. This has occasioned a great deal of concern, especially in Congress, and the housing bill approved at the end of 1983 required that over half the grant be spent on activities benefitting the poor. This comes after two years of debate over such questions as what the statute actually means, and what really are the purposes of the program. Much less attention has been given to the actual budget changes in CDBG--about a $200 million reduction per year from the FY1981 level of about $3.7 billion.

My view is that the issue is trivial. Despite much ingenuity, we simply do not know very much about how the block grants are actually spent--what activities occur that would not occur without them. Some of the activities are "public goods," which confer benefits on all residents of a neighborhood, or the whole city, and the benefits cannot meaningfully be assigned to individuals. Moreover, apart from housing rehabilitation grants and loans, where the income of the owner or tenant can be ascertained, the requirement is in practice more applicable to neighborhoods than to people--benefits to an area consisting largely of low-income households are counted as low-income benefits. This means that creative accounting and creative cartography at the local level should enable the city to do almost anything that it wishes with the money.

Neither public housing demolition or CDBG income targetting is very important, but they have occasioned an extraordinary amount of criticism. It can be argued that the CDBG changes were consistent with the Adminstration's overall policy thrust of increasing local control and responsibility for local problems, but their effect would probably have been imperceptible.

CONCLUSION

The Reagan Administration has had the twin objectives of restraining the rate of cost increase in housing subsidies, and restructuring basic housing policy. It has been somewhat successful in both, but has attracted criticism from many quarters, not all of it consistent. It may be useful to look at some of these objections.

The Administration has attempted to cut the growth in both total program costs, and per-unit subsidies. It has reduced the number of additional units coming under subsidy each year, and has considered a "cap" in the total number of units to be subsidized. This has concerned a number of analysts, from both parties, who argue that the subsidized housing programs have been inequitable because they are limited, and who believe that housing subsidies, like Food Stamps, should be an entitlement program, open to all households who meet the income eligibility requirements.[23] The experience with the housing allowance experiment, which was operated as an entitlement in two metropolitan areas, suggests that the additional cost, for a program utilizing the existing housing stock and similar to the housing allowance, would not be especially large.

An entitlement program is certainly preferable to the present or the proposed program on grounds of equity. But the track record of housing programs is that they have invariably cost more than originally expected, and have developed unforeseen structural problems as they expanded. And an Administration that has had to wrestle with the budgetary consequences of past entitlement programs may be forgiven for moving slowly on setting up a new one, and for being skeptical--even unduly skeptical--about the validity of the housing allowance experimental findings on program participation.

But there would be particular advantages to this Administration from an entitlement housing program, as well as costs. It is not possible to address systematically the continually rising costs of public housing operations, except on a piecemeal basis. With entitlement, public housing residents could be offered vouchers along with all other low-income households, and public housing authorities would be subject to the discipline of the marketplace, which would be consistent with the basic rationale for the Administration's Housing Payment Certificate program. The really "bad" projects could be identified easily, and either upgraded or removed from the inventory.

The cost increases imposed on the poor, such as the higher rent/income ratio and the lower FMR, are more open to criticism. The most cogent argument for them is that housing costs have been rising for most Americans, as financial deregulation eliminates the protected position of housing in the capital markets, and raises the mortgage rate, particularly for homebuyers. If the real price of housing is indeed rising in the 1980s, as is often alleged, than it is perhaps not unreasonable that housing subsidies should reflect this fact. The issue of horizontal equity also applies; if the very large per-unit subsidies now being received by assisted households are cut slightly, there may be more money to extend subsidies to other equally poor families, and we may move to an entitlement program a bit more rapidly than we otherwise would. But so far, of course, we have not moved very far.

At the same time, however, the Reagan Administration has advocated or accepted program changes which raise per-unit costs. It has targetted housing subsidies more narrowly on the lowest-income households by lowering the maximum income from 80 to 50 percent of the local median. It has proposed to let housing certificate holders keep any difference between the payment standard and their actual rent. It approved the FY1982 inflation adjustment in public housing operating subsidies, and proposed a catch-up modernization program in FY1984. All of these changes were advocated before 1981; the Administration has not received much credit for trying to bring them about.

The Administration's most important policy initiatives have been only partly successful. It has been unable to reform the increasingly expensive operating subsidy mechanisms for public housing. It has succeeded in terminating the Section 8 New Construction program, and halting new public housing projects. It has not stopped all new subsidized construction programs, however. It has also tried to move cautiously in the direction of a housing allowance, but has been unsuccessful in persuading Congress to go even as far as it has asked. Congressional reluctance to approve the Housing Payment Certificate, and insistence on a "voucher demonstration"--after ten years of a housing allowance experiment and nine years of Section 8 Existing Housing--is a remarkable contrast to its willingness to vote a new subsidized production program, costing more than twice the demonstration program to start with.

Moreover, as the Administration has tried to shift policy, it has run into transition problems. Commitments made under the construction programs remain outstanding. It has tried to minimize these commitments, which seems appropriate, given the high costs and other problems of the programs. But the result of all this is that the Administration has been criticized by advocates of public housing, especially the local housing authorities, for terminating the construction programs, and by advocates of the housing allowance for not going far enough.

The Administration has some potentially important achievements in housing policy to its credit. But it is not yet clear whether they are merely temporary--as for instance was the moritorium imposed by President Nixon in 1973--or whether they represent a major change in housing policy. The 1983 housing bill suggests that the former possibility is increasingly likely, unfortunately.

FOOTNOTES

1. See for example, Edgar O. Olsen and Stuart M. Butler, "Housing and Urban Development," in Richard N. Holwill, editor, Agenda '83 (Washington: Heritage Foundation, 1983); and Raymond J. Struyk, Neil Mayer and John A. Tuccillo, Federal Housing Policy at President Reagan's Midterm (Washington: Urban Institute Press, 1983), Ch. 6.

2. For an extended discussion of the history of housing policy, see John C. Weicher, Housing: Federal Policies and Programs (Washington: American Enterprise Institute, 1980), Ch. 3.

3. Most housing programs are known by the section number of the National Housing Act, or the number in the law which created them, probably because there are not many synonyms in the English language for "mortgage interest rate subsidy," which the mechanism used in nearly all of them.

4. For full discussions of the housing allowance experiments, see Raymond J. Struyk and Marc Bendick, jr., editors, Housing Vouchers for the Poor--Lessons from a National Experiment (Washington, Urban Institute Press, 1981).

5. For a more extensive discussion of FMRs, see Weicher, Housing pp. 68-73.

6. For further discussion of the concepts of budget authority, contract authority, and outlays, which are especially important in subsidized housing programs, see Weicher, Housing, pp. 1-2.

7. This comparison overstates the relative cost of Section 8, because the budget figures are for future years, when the units being reserved in 1980 are actually built and occupied. A rent inflation of 10 percent per year for three years would reduce the disparity to about 25 percent. On the other hand, the Section 8 units are typically smaller than the units in the existing inventory; 77 percent were efficiency or one-bedroom apartments, compared to 38 percent of all rental units.

8. All reported budget authority figures exclude public housing modernization funds, but include amendments and lease adjustments.

9. "HUD's 1985 Budget Letter to OMB Asks $8 Billion for Assisted Housing," Housing and Development Reporter, October 24, 1983, pp. 443-444.

10. In the mid-1960s the typical family admitted to public housing had an income of about $2,500; by 1978 this had declined to $2,000, measured in 1967 dollars. The typical 1967 tenant was in the 10th percentile of the income distribution, meaning that 90 percent of

American families had higher incomes; the typical 1978 tenant was in the fifth percentile.

11. Prior to 1969, subsidies were available for units occupied by elderly and handicapped tenants, on a small scale.

12. Frank deLeeuw, Operating Costs in Public Housing: A Financial Crisis (Washington, D.C.: The Urban Institute, 1974).

13. I am indebted to Robert Gair and Paul Gatons of HUD for these figures.

14. Roberta Drews, Federal Subsidies for Public Housing: Issues and Options, Congressional Budget Office, June 1983, pp. 29-30.

15. These calculations omit the "replacement allowance," which is discussed in the next section.

16. U.S. Office of Management and Budget, Major Themes and Additional Budget Details, FY1984, pp. 48-50.

17. Struyk et al., Federal Housing Policy, p. 77.

18. "HUD's 1985 Budget Letter," Housing and Development Reporter, October 24, 1983, pp. 443-444.

19. Drews, Public Housing Subsidies, p. 47.

20. Raymond J. Struyk, A New System for Public Housing, Washington: Urban Institute, 1980, pp. 97-98.

21. Perkins and Will and the Ehrenkrantz Group, An Evaluation of the Physical Condition of Public Housing Stock: Final Report, vol. 1. Quoted in Drews, Public Housing Subsidies, pp. 16-20.

22. Drews, Public Housing Subsidies, pp. 49-51.

23. Olsen and Butler, "Housing and Urban Development," pp. 172-175; Raymond J. Struyk and John A. Tuccillo, "Defining the Federal Role in Housing: Bank to Basics," Journal of Urban Economics, vol. 14, no. 2 (September 1983), pp. 219-222.

TABLE 1

HUD SUBSIDIZED HOUSING PROGRAMS, 1975-1984

	1975	1976[1]	1977	1978	1979	1980	1981	1982	1983	1984
Additional Commitments:										
Total (1,000 Units)	92	517	388	326	325	206	178	146	108	100
% New Construction	40	39	52	55	61	63	43	28	15	30
New Budget Authority ($ billions[2])	N.A.[3]	18.0	27.3	30.7	24.0	25.7	18.1	8.5	7.5	5.9
Total Number of Assisted Households (millions)	2.1	2.3	2.8	2.8	3.0	3.3	3.7	3.7	3.9	4.1

Notes:

[1]Includes Transition Quarter

[2]Excludes public housing modernization funds

[3]Not comparable to later years

Source: Hud budgets; Housing and Development Reporter for FY1983 and FY1984

TABLE 2

PUBLIC HOUSING OPERATING SUBSIDIES, 1969-1984

Fiscal Year	Total ($ millions): Budget Authority	Total ($ millions): Outlays	$ Per Unit Month	% of Operating Costs
1969	15	13	1	2
1970	31	28	2	4
1971	108	44	5	8
1972	245	177	13	22
1973	328	299	14	24
1974	320	276	25	35
1975	475	340	26	34
1976[1]	611	508	36	38
1977	591	522	39	37
1978	662	695	45	39
1979	727	655	51	40
1980	862	824	60	42
1981	1002	929	72	44
1982	1350	1008	70	41
1983	1281	N.A.	N.A.	N.A.
1984	1362	N.A.	N.A.	N.A.

Note:

[1] Total figures include Transition Quarter; others exclude it

Source: HUD budget office and unpublished data

TABLE 3

PUBLIC HOUSING MODERNIZATION FUNDS, 1968-1984

Fiscal Year	Capital Costs Financed by Contract Authority ($ millions)
1968	125
1969	135
1970	90
1971	235
1972	235
1973	249
1974	0[1]
1975	423
1976	214[2]
1977	324
1978	448
1979	544
1980	545
1981	927
1982	858
1983	1272
1984	770

Notes:

1 Moratorium for program evaluation
2 Includes Transition Quarter funding ($52 million)

Source: HUD Budget Office; Housing and Development Reporter