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# PUBLIC HOUSING SQUEEZED BETWEEN HIGHER UTILITY COSTS AND STAGNANT FUNDING

## Low-Income Families Will Bear Brunt of Shortfalls

by Will Fischer

The nation's public housing units provide affordable homes to about 1.1 million low-income households, approximately half of which are headed by people who are elderly or have disabilities. The local housing agencies that administer these units are required by federal law to rent them to low-income families at rents the families can afford. Those rents are often inadequate to cover the costs of operating the housing, such as maintenance, security, and utilities. Accordingly, the federal government provides operating subsidies to make up the difference.

In recent years, however, the amount of funding Congress has provided for public housing operating subsidies has been inadequate to bridge the gap between rents and operating costs, with the shortfalls increasing with each passing year. Rising utility rates are a major factor behind the growing shortfalls.

Consumer Price Index data show that utility prices rose by 16 percent from December 2004 to December 2005. Utility inflation eased during early 2006 and projections from the Department of Energy suggest that utility prices will dip somewhat in late 2006. But prices in 2007 are nevertheless expected to remain far above their level at the beginning of 2005. (The Department of Energy projections take into account the bulk of the impact of the recent drop in oil prices. That drop will have only a modest impact on overall utility prices, because oil-based fuels account for a relatively small share of utility costs. Electricity, natural gas, and water — whose prices move largely independently from oil prices — each accounts for a larger share of utility costs.)

**KEY FINDINGS**

- **A House-passed 2007 funding bill would result in the deepest shortfall in public housing operating subsidies — the funds that enable local housing agencies to maintain developments, pay utility bills, and keep rents affordable to needy families — in more than 25 years. The Senate Appropriations Committee passed a version that provides some added funds but still falls far short of what is needed.**
- **Much of the underfunding stems from HUD's failure to request funds to cover sharp utility cost growth in recent years.**
- **Faced with deep shortfalls in 2007, many local housing agencies will have to balance their budgets through steps that harm the vulnerable people they serve, about half of whom are elderly or have disabilities.**
- **Funding shortfalls in 2005 and 2006 have already forced some agencies to raise rents on the neediest households, defer safety-related improvements, and make other painful cuts.**

The Department of Housing and Urban Development (HUD) did not request funding for fiscal year 2007 to reflect growth in utility costs since the start of 2005. As a result, the 2007 HUD appropriations bill passed by the House — which provides the funding level HUD requested — would provide agencies with only about *79 percent* of the public housing operating subsidies for which they are legally eligible under the federal formula for determining operating subsidy needs. This would be the deepest shortfall in operating subsidy funding in more than 25 years. A version of the bill passed by the Senate provides almost $100 million more than the House bill but still falls well short of need.

Housing agencies that receive inadequate federal subsidies must raise revenues, cut operating costs, or tap other resources to make up the shortfall. Some agencies have been able to make ends meet through relatively painless measures, such as drawing down reserves or improving administrative efficiency. But as shortfalls have grown deeper and have continued year after year, a growing number of agencies have had no choice but to take measures that harm the vulnerable people they serve, including:

- **passing higher utility charges on to low-income tenants** who already are struggling to make ends meet;
- **shifting public housing apartments from the poorest tenants to higher-income tenants,** who can afford to pay higher rents but have less need for housing assistance; and
- **cutting budgets for maintenance of public housing,** including eliminating funds for important safety measures such as sprinkler systems.

Unless Congress stems the growing shortfalls in operating subsidies, more and more housing agencies will be forced to take steps that impose significant burdens on public housing tenants. Congress could reduce the severity of housing agencies' shortfall for 2007 by providing at least $290 million beyond the funding level in the House bill to cover the surge in utility prices that HUD's budget request ignored. It also is vital that the Administration request full funding for operating subsidies in fiscal year 2008.

## Funding Shortfalls Have Grown Increasingly Severe

The amount that each local housing agency is eligible to receive to cover the gap between public housing rent revenues and operating costs is set by a federal formula.[1] In some years, Congress has failed to provide sufficient funding to cover the full subsidies that housing agencies are eligible for under the formula. When this occurs, HUD provides each agency with a pro-rated share of the funds for which the agency is eligible. Until recently, such "pro-rations" were common but generally small. According to HUD, the Department pro-rated funding in 12 of the 24 years from 1981 to 2004, but agencies received an average of 98 cents for every dollar they were due.[2]

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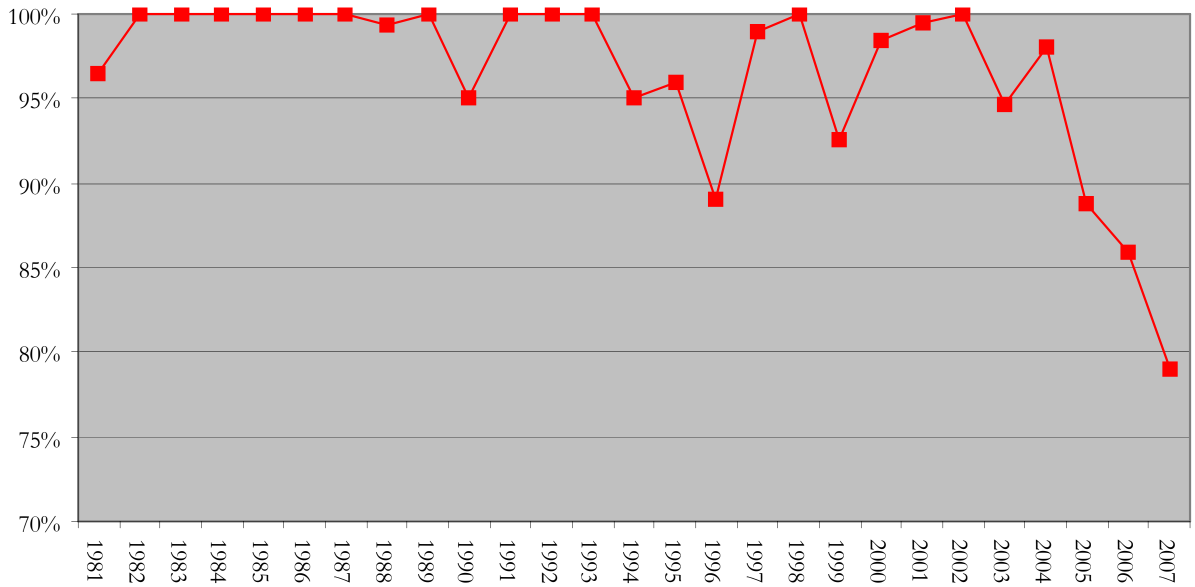
[1] As discussed further below, housing agencies receive separate funding each year to cover major repairs and other capital costs.

[2] HUD's list of historic pro-ration levels is available on the internet at http://www.hud.gov/offices/pih/programs/ph/am/of/prorationlevels.pdf.

**FIGURE 1**

**Public Housing Operating Fund Shortfalls Have Grown Increasingly Severe**

Operating Fund Pro-Rations by Fiscal Year




*Note:* 1981-2006 pro-rations as reported by HUD. 2007 pro-ration calculated based on Administration funding request and CBPP estimate of total operating subsidy eligibility.

In the last several years, however, funding shortfalls have become increasingly severe. Housing agencies received 98 percent of the funding they were due in 2004, but in 2005 this percentage fell to just under 89 percent — the deepest pro-ration housing agencies had faced in more than 25 years. HUD has announced that the pro-ration for 2006 is even deeper: agencies are receiving 86 percent of the funding they are due.

For 2007, HUD's budget request would freeze operating subsidy funding at the 2006 level of $3.56 billion, well below the $4.18 billion that the accompanying Budget Justifications that HUD submitted to Congress estimated to be needed to provide agencies with the full funding they are due under the formula. If HUD's estimate were accurate, the proposed funding freeze would push the pro-ration percentage down to a new low of 85 percent in 2007.

It is nearly certain, however, that a funding freeze will result in a pro-ration percentage *well below* 85 percent and consequently lead to operating subsidy shortfalls even more severe than HUD's estimate suggests. This is because, as explained below, HUD's estimate did not take into account the sharp surge in utility costs that has occurred as a result of increases in energy prices. Utility costs constitute one of the largest components of public housing operating costs.

## HUD Estimates Fail to Reflect Increase in Utility Costs

According to Consumer Price Index data, the average price of household fuels and utilities rose by 16 percent nationally between December 2004 and December 2005. HUD announced *in July 2006* that housing agencies were eligible for *$1.64 billion in utility-related funding in 2006*. This is $283 million higher than the 2005 eligibility level (see Table 1) which was set based largely on data for a period prior to the surge in utility costs.[3]

**Table 1: Operating Subsidies for Utility Costs Under the HUD Formula**

| Year | Formula Eligibility |
|---|---|
| 2005 (Actual) | $1.354 billion |
| 2006 (February 2006 HUD estimate) | $1.412 billion |
| 2006 (Actual from HUD) | $1.637 billion |
| 2007 (February 2006 HUD estimate) | $1.386 billion |
| 2007 (CBPP conservative estimate) | $1.674 billion |

Yet the 2007 Budget Justifications that HUD submitted five months earlier, in February 2006, estimated that housing agencies would be eligible for $1.39 billion to cover utility costs in 2007. HUD based that figure in part on an estimate that agencies would be eligible for $1.41 billion in utility-related funding in 2006; this 2006 eligibility estimate was shown to be *$230 million too low* when HUD announced the actual 2006 eligibility figure of $1.64 billion five months later. (The 2006 estimate in the Budget Justifications was only 4.3 percent, or $58 million above the actual 2005 level that had been set based on data from the period before the 2005 utility price surge. This suggests that HUD did not take the price surge fully into account in developing the Budget Justifications; HUD had not yet totaled agencies' actual 2006 eligibility when it submitted its 2007 budget in February 2006, although price data demonstrating sharp growth in utility prices during 2005 had been available for a number of months.)

In addition to starting from a 2006 base that failed to take inflation during 2005 adequately into account, HUD's justifications assumed that under the formula, eligibility for utility-related funding would drop between 2006 and 2007. It now is evident, however, that utility rate trends will not cause eligibility to drop in this manner. Overall prices for utilities during the first half of 2006 were 1.4 percent *higher* than the December 2006 level. (Utility prices during the second half of 2006 and during 2007 will not affect the 2007 eligibility level under the operating subsidy formula, because the eligibility level is based on data from earlier periods.)

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[3] In the federal fiscal year 2005 HUD appropriations act, Congress for the first time instructed HUD to distribute operating subsidies on a *calendar year* basis. Previously, each agency received funds based on its own fiscal year, which could end at the end of any calendar quarter. For example, HUD distributed operating subsidies provided in the federal fiscal year 2004 appropriations bill to cover the periods from January to December 2004, April 2004 to March 2005, July 2004 to June 2005, or October 2004 to September 2005 — depending on each agency's fiscal year end date.

When Congress switched to calendar year funding in 2005, HUD therefore had already provided agencies that have March, June, or September fiscal year end dates with fiscal year 2004 funds that covered a portion of calendar year 2005. To reflect this calendar year shift, HUD reduced each agency's 2005 eligibility based on the share of calendar year 2005 that was already covered by the agency's fiscal year 2004 funds. An agency with a March 2005 fiscal year end, for example, was only eligible for 75 percent of its full 2005 eligibility. HUD, however, has released the 2005 full-year eligibility totals it calculated before making reductions to reflect the calendar year shift. All references to 2005 eligibility in this analysis refer to those full-year levels, since the full -year levels are comparable to eligibility levels in other years.

HUD will determine utility eligibility in 2007 using a somewhat different formula from the one it used in 2006 and prior years. But it is unlikely that this change will push down eligibility. The limited data now available regarding utility consumption and rates suggest that under the new formula, agencies will qualify for at least $1.67 billion to cover agency-paid utility costs in 2007, close to $40 million more than in 2006, and nearly $290 million above what HUD estimated in its budget justifications last February. It also is possible that agencies will be eligible for substantially more than this amount.[4]

**Do Lower Oil Prices Mean Public Housing Utility Costs Will Drop Sharply?**

While utility prices during 2007 will not affect the 2007 eligibility level under the operating subsidy formula, those prices will, of course, affect the actual utility costs that local housing agencies pay.

It is unlikely, however, that recent and anticipated price trends (including the recent drop in oil prices) will cause the utility costs that agencies incur to drop sharply. Calculations based on the most recent Energy Department (DOE) price projections suggest that while utility prices during the second half of 2006 will be about 3.2 percent below prices during the first half of 2006, prices will rebound and will be slightly higher during 2007 than in the first half of 2006.[a]

These DOE projections, issued on October 10, 2006, use actual price data through September 2006. They consequently take into account the great majority of the sharp drop (more than 23 percent) in crude oil prices that has occurred since mid-July. That decline will have only a modest impact on overall utility costs, however, because oil prices play a relatively small role in determining overall utility prices.

Natural gas, electricity (generated primarily using coal, natural gas, nuclear, and hydroelectric power) and water each accounts for a larger share of utility costs than oil-based fuels. Prices for those other utilities generally rise and fall largely independently from oil prices. As oil prices dropped during late summer 2006, natural gas prices also declined sharply. But the impact of those price declines on overall utility prices was diluted by electricity and water prices, which held nearly steady.

The weak link between oil prices and utility prices overall was also demonstrated during February-May 2006. During that period, the price of crude oil rose by 15 percent, and average gasoline prices (which are closely linked to oil prices) went up by 63 cents per gallon. Yet the CPI Fuel and Utilities index *declined* by 1 percent.[b]

[a] Because the Department of Energy does not issue a combined projection for all utilities together, we rely here on a composite projection that we calculated by weighting projections for individual utilities according to the weight they receive in the Consumer Price Index. Projections for energy utility prices are drawn from the October 2006 Department of Energy document "Short-Term Energy Outlook." Projections for water and other non-energy utilities (which tend to be less volatile than energy prices) assume that recent CPI trends will continue.

[b] The price of crude oil referred to here is the monthly average of "spot" prices of West Texas Intermediate crude oil, a common benchmark of crude oil prices. The price of gasoline is the average pump price of regular self-serve gasoline, according to a Department of Energy survey.

If housing agencies are eligible for $1.67 billion to cover utility costs in 2007, then HUD's overall request for $3.56 billion in funding for operating subsidies — which the House adopted in the 2007

[4] The calculations used to derive the $1.67 billion estimate are described in the Appendix.

HUD appropriations bill that it approved on June 14 — would provide only *79 percent* of the subsidies that housing agencies will be due under the formula in 2007.[5]

The Senate Appropriations Committee provided $3.66 billion for operating subsidies when it adopted its version of the HUD appropriations bill on July 20. This is $100 million above the House bill but would be enough to cover only 81 percent of the subsidy level that housing agencies will be due.[6]

## Shortfalls Force Housing Agencies to Take Steps That Harm Poor Families

Shortfalls of this magnitude would have serious consequences for public housing and the vulnerable people it serves. When the operating subsidies provided to an agency are inadequate, the agency must reduce its operating costs, generate added payments from tenants, or tap other resources to make up the difference. Some agencies experiencing subsidy shortfalls in recent years have drawn on reserves or improved administrative efficiency. But as shortfalls have deepened and been sustained year after year, more agencies are finding themselves unable to make ends meet through these relatively painless measures alone.

In most cases, housing agencies cannot simply raise tenant rents, because federal law requires that agencies set rental charges at affordable levels, generally defined as no more than 30 percent of the tenant's income. But the steps that agencies can take to close the gaps between increased utility costs and stagnant federal subsidies — steps that some agencies have already been forced to make in response to shortfalls in 2005 and 2006 — can harm poor families in other ways.

### Shifting Assistance Away from the Neediest Families

Since tenants' rents are generally set at 30 percent of their income, tenants with higher incomes generate more rental revenue. Housing agencies are permitted to rent the majority of their public housing units to households with incomes as high as 80 percent of the local median income, which on a national basis works out to $47,700 on average for a family of four.

Housing agencies thus can raise added revenue by providing more units to families with incomes near this income limit — and fewer units to poorer families — as units become available. The San Antonio (TX) Housing Authority, for example, has indicated that it expects to cut in half the number of new tenants it admits who have incomes below 30 percent of the area median income.

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[5] This 79 percent figure is based on the assumption that HUD's estimates regarding the components of the funding formula *other* than the utility component are correct. The Congressional Budget Justifications that HUD submitted to Congress with its budget request provide only limited information regarding the methods that HUD used to prepare its estimates of operating costs, so it is difficult to assess the soundness of other components of the estimates.

[6] The $3.56 billion for operating subsidies contained in the Administration request and the House bill include $16 million that would be set aside to support housing agency self-sufficiency programs and to help agencies implement new HUD public housing management requirements that will take effect in 2007. Those funds would not be distributed through the regular operating subsidy formula. The $3.66 billion in the Senate bill also contains $30 million that would be distributed outside the formula to help small housing agencies adjust to new HUD requirements. Since the set asides would not be distributed under the formula, they were not counted in calculating the percentage of the operating subsidies that agencies are due covered by the funds in the bills.

This means that an increasing share of the people who most need housing assistance will fail to receive it. Research shows that families with incomes below 30 percent of the median income (which is $17,900 for a family of four nationally) are far more likely than families with higher incomes to face serious hardship if they do not receive housing assistance.

### Passing Utility Costs on to Tenants

Housing agencies pay most of the cost of utilities in public housing. In some cases, agencies pay utility bills directly. In other cases, tenants pay their own utility bills but are allowed to deduct most of their utility costs from their rent. Under either approach, agencies are able to charge tenants for "excess" utility costs.

- An agency that pays the utility bills itself can impose surcharges for certain types of appliances that use large amounts of energy, including some necessary items such as air conditioners in hot climates.

- An agency whose tenants pay the utility bills can cap the amount of utility costs that tenants may deduct from their rent payments; the amount is capped at the level of an agency-set "utility allowance." The tenant must bear any costs above the cap.

Housing agencies have substantial discretion to set utility allowance levels, and not every agency provides sufficient allowances to cover tenants' reasonable utility costs.[7] Agencies also have some flexibility to decide which appliances will be subject to a surcharge and the amount of the surcharge.[8] Housing agencies that face shortfalls will face strong pressure to use this discretion in ways that maximize their revenues. Because of a shortfall in 2006, for example, the St. Paul Housing Agency delayed an allowance increase of close to 10 percent that the agency believed was needed to reflect higher utility rates. The New York City Housing Authority has responded to its funding shortfall by modestly raising surcharges for certain appliances. Other agencies may be forced to impose more severe increases.

In some cases, higher utility costs can pose difficult burdens for public housing tenants, most of whom are poor and already struggling to make ends meet. Some tenants may respond by shifting resources from other basic needs, such as food, medications, or clothing for school or work. Others may reduce their use of utilities, including air conditioning or heating — a step that could pose health risks in some cases, particularly for tenants who are elderly or have disabilities.

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[7] HUD regulations require that allowances "approximate a reasonable consumption of utilities by an energy-conservative household…" In some cases, however, agencies either interpret this requirement in a manner that results in inadequate allowances (for example, by not fully taking into account particular structural characteristics of a building that cause utility costs to be higher than normal) or fail to update the allowances when costs rise. In addition, it appears that HUD fails to monitor agencies sufficiently to ensure that they consistently comply with this requirement.

[8] Some agencies that pay bills to utility companies allocate certain utility costs to tenants using a system called "check metering." Under this system, a monitor tracks how much of a utility each tenant household uses. The agency sets an allowance (in units of fuel or some other measure of utility quantity), and tenants are charged for consumption above the allowance, based on current utility rates. Tenants must pay these charges in addition to their regular rent payments. As with monetary allowances for tenant-paid utilities, housing agencies that use check metering are required to set allowances at reasonable levels, but a housing agency may interpret that requirement in a manner that imposes extra charges even on some tenants with relatively modest utility consumption.

### Raising Rents on the Poorest Households

Housing agencies are permitted to impose a minimum rent of up to $50 per month on public housing residents, including those with little or no income. Many agencies have chosen not to use this option due to the hardship it can cause for destitute residents. Some agencies, however, are imposing new minimum rents or raising existing minimum rents to make up for inadequate operating subsidies. The St. Paul (MN) Housing Agency, for example, has responded to a funding shortfall by announcing that it will raise its minimum monthly rent from $25 to $50 in October 2006.

### Reducing Maintenance of Public Housing Developments

Nearly half of the non-utility operating costs that housing agencies incur for public housing developments are costs for maintenance. As a result, a growing number of housing agencies may feel compelled to scale back maintenance expenditures to cope with deficits. According to press reports, a number of housing agencies, including the Camden (NJ) Housing Authority and Mobile (AL) Housing Authority, are already planning to reduce spending on public housing maintenance.

In some cases, maintenance cutbacks could leave serious safety hazards unaddressed, such as defective locks and fire protection systems or broken heaters during the winter. The St. Paul Housing Agency, for example, has deferred installing automatic sprinkler systems in high-rise housing developments for the elderly. Other agencies may opt to reduce spending for upkeep of grounds and building exteriors, which could harm local communities by leading to neighborhood blight.

Furthermore, reducing maintenance often will raise costs over the longer term. If an agency has fewer maintenance staff, preparing vacant units for new occupants will take longer, which in turn will reduce the agency's rent revenue (as well as leave needy applicants languishing on public housing waiting lists for longer periods). In addition, deferring minor repairs, such as for water leaks, can result in more serious damage later on.

## Continued Shortfalls Could Permanently Reduce Public Housing Stock

Some agencies will likely conclude that they cannot reduce their operating costs enough or squeeze sufficient revenues from tenants to make up the shortfall in federal operating subsidies — or that such steps would cause unacceptable harm. These agencies may ultimately respond by demolishing public housing developments or selling them to developers, who may not allow all current tenants to remain. Press reports indicate that the Salt Lake City (UT) Housing Authority, for example, has announced plans to sell 250 of its 633 public housing units because, in the words of the city's housing operations director, "We're just not willing to watch our beautiful housing stock deteriorate."

Agency decisions to reduce their public housing stock will be influenced not only by the recent operating fund shortfalls but also by the federal government's longstanding failure to provide adequate *capital* funding for modernization of aging public housing developments. More than

100,000 public housing apartments have been lost since the mid-1990s, often because inadequate resources were available to renovate them.[9]

Congress appropriates public housing capital funds each year separately from funding for operating subsidies. Capital funding has been cut repeatedly in recent years, falling from $3.0 billion in 1999 to $2.4 billion in 2006. In addition, Congress has cut the other major source of funding that can be used for public housing capital needs — the HOPE VI program for revitalizing severely distressed housing projects — even more sharply. Only $99 million was provided for HOPE VI in 2006, down from $625 million in 1999.

Demolition or sale may be appropriate for some obsolete, poorly designed, or poorly located housing developments, and many such developments have already been demolished or sold. This decision, however, should be made by the housing agency, residents, and other members of the community based on an assessment of local circumstances, not out of desperation because the federal government has failed to meet its funding obligations.

## Additional Funds Needed to Limit Damaging Cuts

The surest way for Congress to prevent harmful consequences like those outlined above would be to appropriate the full amount needed under the operating subsidy formula. Neither HUD nor Congress has provided a rationale explaining why agencies should receive less than the amount for which they are legally eligible. Indeed, Congress mandated in 1999 that HUD undertake an extensive revision process intended to make the formula fairer and more reflective of the amounts agencies actually need to administer well-run public housing; the revised formula will take effect for the first time in 2007.

To *fully fund* agencies' operating subsidies in 2007 would require an appropriation of approximately $4.5 billion, close to $1 billion above the level in the House bill and the Administration request.

Because congressional leaders have committed to keeping total domestic appropriations within tight caps proposed by the Administration, it appears extremely unlikely that Congress will provide an increase of this magnitude in 2007. Congress could, however, at least limit the severity of the cuts that housing agencies face by providing the additional funding needed to cover the surge in utility prices that HUD's budget request failed to reflect. As noted, doing so would require an appropriation of $3.85 billion for operating subsidies, $290 million above the level in the House bill. Even with this increase, agencies would receive only 86 percent of the subsidies they are due in 2007, the same percentage they received in 2006. But these extra funds at least would halt the steady decline in pro-ration levels in recent years, which is forcing housing agencies to impose continually harsher cuts with each passing year.

It is important to emphasize that higher operating subsidy funding in 2007 should not come at the expense of funding for the public housing capital fund or the tenant- or project-based Section 8

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[9] HUD's Performance and Accountability Report (PAR) for 2002 lists 1,273,500 public housing units as "eligible for payment" in 1999. The 2005 PAR report list 1,162,808 units in a comparable category in 2005, a decline of 110,697. A substantial number of units were lost before 1999, however, so this understates the total loss of units.

programs. Public housing and Section 8 are the largest federal housing programs that target low-income households. Congress should place priority on adequately funding both of them.

Finally, regardless of the final funding level for 2007, it is vital that the Administration request full funding for public housing operating costs in its 2008 budget (to be submitted in February 2007), and that Congress meet that request. As noted above, housing agencies cope with shortfalls in part through temporary measures — like tapping reserves or deferring maintenance — that cannot be sustained indefinitely. Fiscal year 2007 will be the fifth straight year in which housing agencies' operating subsidies are pro-rated.

Housing agencies have never previously absorbed operating subsidy shortfalls for more than four straight years, let alone shortfalls as deep as those that have occurred since 2005. If the federal government continues to fail to meet its funding obligations, the nation's public housing developments and the low-income people who rely on them for shelter will pay an increasingly heavy price.