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Revised July 15, 2004

FURTHER ACTION BY HUD NEEDED TO HALT CUTS IN HOUSING ASSISTANCE FOR LOW-INCOME FAMILIES

HUD Policy Is Forcing Many Housing Agencies to Impose Cuts Even Though Congress Provided Sufficient Funding to Support All Vouchers

by Barbara Sard and Will Fischer

On April 22, the Department of Housing and Urban Development announced a far-reaching change in its policy for funding "Section 8" housing vouchers. The new HUD policy will result in many state and local housing agencies failing to receive sufficient funding to continue supporting all vouchers now in use. In testimony before the House Financial Services Committee on May 20, HUD Secretary Alphonso Jackson announced steps HUD will take to mitigate the harmful effects of the new policy. These steps are not sufficient, however, to prevent cuts in housing assistance this year.

HUD's new fiscal year 2004 funding policy (which is distinct from an Administration budget proposal to cut voucher funding sharply in fiscal year 2005 and to convert the program to a block grant) is compelling state and local housing agencies to institute cuts in assistance that will cause significant hardship among low-income families. The actions that Secretary Jackson announced on May 20 — correcting an error in the method that HUD initially used to calculate funding levels for some agencies and providing added funds for reserve accounts that agencies can use to cover shortfalls — reduced the magnitude of the required reductions, but have not eliminated the need for harsh cuts in some communities.

For example, some agencies are raising rent burdens on low-income families that receive vouchers by reducing the maximum amount of rent a voucher can cover. Other agencies are reducing the number of families assisted, by rescinding vouchers provided to families that are searching for housing but have not yet found a unit to rent with their voucher, and by "shelving" vouchers that become available when current voucher holders leave the program (rather than reissuing the vouchers to needy families on waiting lists as is the normal practice). For some agencies, the shortfalls created by the new HUD policy are so severe that the agencies have no alternative but to terminate assistance to some low-income families that currently rely on vouchers to help pay the rent. Such terminations of assistance have already begun to occur.

Under the fiscal year 2004 appropriations law enacted in January, HUD could have taken — and still can take — stronger steps that would largely avert housing assistance cuts. HUD has acknowledged that it has $190 million in funds that could be used to cover shortfalls under its new policy, but has failed to institute measures to distribute these funds to many of the housing agencies that otherwise will be forced to reduce assistance to needy families.

HUD Policy Provides Less Funding than Is Needed to Pay for Vouchers Now in Use

Traditionally, HUD has provided state and local housing agencies with sufficient funds to cover the costs of the vouchers they are authorized to administer. In a notice released on April 22, 2004 (PIH 2004-7), however, HUD put in place a new system for funding vouchers in fiscal year 2004 that departs sharply from previous practice.

Under the new system, HUD will limit the average amount of funding that a state or local agency receives for each voucher in use to the agency's average cost per-voucher in May-July 2003, plus an adjustment for rent inflation that has occurred since that time in the agency's region of the country, as determined in accordance with a rent inflation formula HUD has devised.

Voucher costs at many housing agencies have risen since July 2003 at a faster or slower rate than the regional rent inflation factor that the HUD formula uses (which is often based on inflation in a region encompassing several states), and generally have done so for legitimate reasons. If an agency's average voucher costs have risen faster than HUD's rent inflation factor, however, the agency will not receive sufficient funds to pay landlords for all vouchers now in use. In such cases, housing agencies will be able to receive additional funds to address the shortfalls the new HUD policy creates only if they are successful in an appeal to HUD for a larger cost adjustment. Based on the information that HUD has provided about the timeline of the appeals process and the permitted grounds for appeal, it appears unlikely that this process will provide adequate or timely relief to local agencies that will be underfunded as a result of HUD's new policy.

Some agencies have access to "program reserve" funds that can be used to make up for a shortfall in HUD funding. But despite the distribution of $152 million in additional reserve funds to local agencies, announced by Secretary Jackson on May 20, HUD has fallen short of providing many agencies with reserve funding that brings the reserves to their traditional levels. As a result, many agencies' reserves are too small to make up for the under-funding that is resulting from HUD's new policy. Furthermore, as discussed below, other measures that HUD has instituted may deter even agencies that have adequate reserves from using those reserves to cover the gap between their actual voucher costs and the funding levels they are now receiving from HUD; such agencies may thus feel compelled to institute cuts anyway.[1]

[1] Some agencies also may have another type of reserve, referred to as an administrative fee reserve. If an agency does not need all of the administrative funds it receives from HUD to administer the voucher program in a given year, it is permitted to retain the remaining amount (or a portion of the remainder) in a reserve fund. Administrative fee reserves could be used to cover the voucher funding shortfalls, but it is uncertain how much funding is currently available in these reserves or how many local agencies possess them.

Furthermore, most agencies will need to draw on their administrative fee reserves in 2004 to meet the current expenses of administering their voucher programs because of a sharp, retroactive reduction in the administrative fees that HUD is paying agencies in 2004. In late May, HUD notified agencies of the amount of administrative fees they would earn per voucher in 2004. On average, fees were estimated to be reduced about 13 percent compared to last year. After a firestorm of protest, HUD agreed the following week to recalculate administrative fees in a manner that would be more consistent with the directive in the 2004 appropriations act. On June 3, HUD staff told PHA

The adverse effects of the new HUD policy are intensified by the late date on which the policy was announced and HUD's failure to clarify important details of the policy for several more months. The delay in announcing the policy reduced the amount of time available to housing agencies to plan for and respond to it, and is forcing agencies to impose deeper cuts than otherwise would have been necessary to adapt to the reduced levels of funding. While some housing agencies received advance information, most were not informed by HUD about the policy until the April 22 notice was released more than three months after Congress passed the fiscal year 2004 appropriations legislation. Moreover, agencies were not told the specific amount of funding they would receive (which could *not* be calculated from the information in the April 22 notice) until the *third week in May*, and did not provide many important specifics of the policy until late June.

Despite these delays, the new funding policy is being implemented *retroactively* to January 1, 2004. HUD provided more funding to many agencies for the months from January through April (and in some cases May) 2004 than the new HUD policy allows them to receive. This occurred because, consistent with what had been standard practice, the agencies received sufficient funds from HUD in those months to cover their actual rental costs. These agencies will be required to *pay back* the "excess" funding before the end of their fiscal year.

Housing agencies do not all have the same fiscal years; local agencies' fiscal years may end on March 31, June 30, September 30, or December 31. The "pay-back" requirement will have different implications for agencies with different fiscal year-end dates. Agencies with funding shortfalls whose fiscal years end June 30 and September 30 are in the most difficult situation. They are required not only to cope with a reduced level of funding for the remainder of their fiscal year due to the new HUD policy, but also to reduce program expenditures enough to make up by June 30 or September 30 for any "overpayments" that HUD provided them in the first four or five months of 2004, before HUD put the new policy in place. If they do not have other funds they can use to meet the shortfall, the fiscal year-end pay-back requirement will force agencies to make cuts that are several times larger than the cuts that would be required if the agencies were given until the end of calendar year 2004 to pay back the "excess" funds.

Policy is Forcing Cuts in Housing Assistance

Agencies that receive insufficient funds from HUD to pay for vouchers in use — and that lack adequate reserve funds to make up the shortfall — will have to reduce voucher program costs. HUD has not made available sufficient data to estimate with precision the magnitude of the cuts that will result from the new policy. Using the data that HUD has made available, combined with data provided by local housing agencies, the National Association of Housing and Redevelopment Officials has estimated that after program reserves are taken into account, agencies will experience shortfalls totaling more than $183 million. NAHRO estimates that this

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representatives that under a new calculation method, fees would be reduced 6.2 percent on average. On June 11, HUD notified agencies of the revised fee levels. It appears that the reduction in fees for individual local agencies paid in 2004 may vary substantially from the 6.2 percent *average* reduction that HUD has cited.

shortfall will cause about 96,000 vouchers to be left unfunded for all or part of the remainder of 2004.[2]

To reduce costs sufficiently to fit within the reduced funding levels that HUD is now providing, many local agencies will have no alternative but to institute measures that adversely affect low-income families.[3] (A table listing 190 agencies that have experienced shortfalls and/or taken steps to cut costs as a result of HUD's policy is available on the internet at http://www.cbpp.org/7-15-04hous.htm. These agencies are simply those for which information is available, and do not represent a complete listing of agencies that experienced adverse consequences due to HUD's policy. This table includes information from press reports, interviews with agency staff, and other sources in addition to the CBPP survey discussed elsewhere in this paper.) The principal actions that local agencies can take to achieve substantial cost reduction include the following:

- **"Shelving" vouchers** that become available when families leave the voucher program on their own, and thereby reducing the number of vouchers in use and the number of low-income households being assisted. For example, the Housing Authority of Portland, Oregon has stopped reissuing vouchers that become

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[2] NAHRO's state-by-state estimates are available on the internet at http://www.nahro.org/documents/2004/0528HUDImpFY2004S8HAPRenForm.pdf.

[3] Some agencies may be able to achieve a portion of the required savings through changes in the administration of their voucher programs that do not harm low-income families. Each housing agency is required to compare the rent for every apartment leased by a voucher holder to market rents for similar units in similar locations and must refuse to make payments on vouchers where the rent is out of line with the local market. If agencies have been lax in their enforcement of this "rent reasonableness" requirement, they could reduce their costs to some degree by reexamining rents and lowering those that are too high in comparison to market rents. Lowering rents to the "reasonable" level does not shift costs to tenants.

The available evidence suggests, however, that agencies generally enforce rent reasonableness quite effectively. In 2001, a study conducted for HUD took the first systematic look at implementation of these requirements by local housing agencies. The study found that the requirements generally were being followed and that the average rent for units occupied by families with housing vouchers was $95 *less per month than* the estimated rents for comparable unassisted units. The study also found that housing voucher units located "in relatively high cost submarkets almost universally have rents less than comparable units. Overall, such units rent for $244 less than comparable rents. Only 3 percent of such units have rents that exceed market rent by 5 percent or more. By contrast, rents in relatively low cost submarkets are, on average…$14 less than comparable rent." These findings suggest that on the whole, housing agencies will have little opportunity to achieve savings by improving enforcement of the rent reasonableness requirement.

Some agencies have indicated that they will go beyond enforcing rent reasonableness and will refuse to allow vouchers to cover any rent increases, even though they are supposed to approve rents that keep pace with rental prices of comparable units in the local market. This step will likely prompt some owners to end their participation in the voucher program. In Willimantic, Connecticut, for example, an owner denied a rent increase by the housing authority is threatening to evict 40 voucher holders with disabilities. In Bakersfield, California, a significant number of minority voucher holders have been able to use their vouchers to move to middle-income neighborhoods that are not predominantly minority. Owners of the large rental complexes providing these improved housing opportunities have indicated that they will not continue to participate in the voucher program if the housing agency does not approve market rents. In such cases, a family may have as little as two months to find another unit in which it can use its voucher. If the family does not succeed, it will lose its voucher assistance.

available through turnover. It expects that it may need to use attrition to reduce the number of families it assists by as many as 260.

About half of state and local agencies responding to a recent survey by the Center on Budget and Policy Priorities who had imposed cuts due to HUD's new voucher funding policy (or were considering doing so) indicated they had stopped issuing new vouchers or were about to do so.[4]

- **Withdrawing vouchers from families that have recently been issued a voucher** but are still looking for an apartment and thus have not yet begun using their vouchers to rent housing. Many such families languished for several years on a waiting list before receiving a voucher. The Memphis Housing Authority has recalled 160 vouchers from families searching for housing. Similarly, the Tacoma (WA) Housing Authority had to notify 180 families that they could not use their recently-issued vouchers due to the severe funding shortfall the agency now faces.

- **Reducing the maximum amount of rent that a voucher can cover.** This step would make it more difficult for voucher holders to live in neighborhoods with more jobs, better schools, and less crime. If a family is unable to find an apartment it can rent at the new, lower maximum rent that the local agency has set, the family will be forced either to bear a larger share of the rent itself or to turn back its voucher. If the maximum amount of rent that a voucher will cover is set well below prevailing rents some families may not be able to use their vouchers at all.[5] (Families receiving voucher assistance that remain in their units, however, currently are protected from the effects of reductions in the maximum

[4] The survey, begun in late May 2004 and currently ongoing, was distributed to hundreds of advocates and housing authority officials around the country. We have received a total of 117 responses to date. Of the agencies for which we received information, 81 reported higher current average voucher costs than the figure HUD was using for the agency. (We do not consider this high rate to reflect the incidence of funding shortfalls nationwide. It is likely that agencies experiencing funding shortfalls would be more likely to complete the survey.) Of the 92 agencies that reported taking one or more step to cut voucher assistance in light of HUD's new funding policy, 68 currently have higher average voucher costs than HUD is funding. The 24 agencies taking actions to reduce program costs that are currently receiving sufficient funding may be concerned that without policy changes their costs by the end of the year would exceed the level HUD will pay for. Agencies that report a shortfall but no specific policy changes to reduce costs may be intending to cover the shortfall with reserve funds or may not yet have determined what actions to take.

[5] The maximum amount of rent that a voucher can cover is known as the voucher "payment standard." Federal funds pay the difference between the payment standard (or the unit rent, if lower) and 30 percent of a family's income. If the cost of rent and utilities exceeds the payment standard, the family pays the extra amount. The poorest families are likely to have particular difficulty using vouchers if the payment standard is very low, because they will have less income available to cover costs beyond the payment standard. Moreover, when families first receive voucher assistance or move to new units, they are prohibited from spending more than 40 percent of their income for rent and utility expenses. This rule is more restrictive for a family with very little income than for a family with more income, since 40 percent of the poorer family's income is a smaller amount. After the first year that a family lives in a unit with voucher assistance, there is no limit on the amount it may pay for rent.

rent for at least a year by federal regulations. As discussed below, HUD has indicated that it plans to eliminate this protection.)[6]

About 60 percent of the agencies that reported cuts of some type in the recent CBPP survey have reduced their payment standards or proposed such actions to their boards of directors. Some of these changes may be quite substantial. For example, the housing agency in Secaucus, New Jersey, has reduced its maximum payment by $163 per month. The agency in Montgomery County, Maryland has reduced its maximum rent by $122.

- **Imposing minimum monthly rental charges on very poor voucher holders** who have little or no income. Housing agencies are permitted to impose a minimum rent of up to $50 per month. Until now, the majority of agencies have chosen not to use this option due to the hardship it can cause for destitute voucher-holders. This may now change. For example, the Montana Department of Commerce, which administers two-thirds of the vouchers in that state, has decided to impose a minimum monthly rent of $50, a change that will raise rents on the poorest 488 families in the program. About 49 percent of all agencies reporting cuts in the CBPP survey have increased minimum rent charges in response to HUD's new funding policy or plan to do so.

- **Providing fewer "project-based" vouchers to support development of affordable housing.** Housing agencies are permitted to require that up to 20 percent of their vouchers be used at designated housing projects. Such "project-basing" allows vouchers to support production of affordable housing by guaranteeing developers a source of rental revenue they can use to repay debt incurred during construction.

  Some housing agencies facing funding shortfalls will be compelled to cancel plans to provide project-based vouchers to new developments and instead leave the vouchers unused. For example, the housing agency in Milford, Connecticut, has cancelled a plan to project-base about 30 vouchers to support construction of transitional housing for the homeless and development of other affordable housing, even though it had already accepted bids from organizations interested in developing the housing. Agencies facing very large shortfalls may have no choice but to break *existing* contracts to designate vouchers for use at particular developments.

- **Reducing participation in the Family Self-Sufficiency (FSS) program**. FSS is an initiative designed to encourage housing assistance recipients to increase their

[6] Under current law, a reduced voucher payment standard would apply immediately to new voucher holders and to families that move with their vouchers from one housing unit to another. For other families, a reduced payment standard can not take effect for at least a year. (See 24 C.F.R. § 982.505(c)(3).) The purpose of this policy is to protect low-income families against sudden increases in their rental obligations and to give them an opportunity to search for a less expensive unit.

earnings and move off welfare. When a family with a voucher raises its earnings, the amount of rent that the family pays normally increases. If a family is participating in FSS, however, the increase is placed in an escrow account that the family can later access if it meets all of the requirements contained in a self-sufficiency plan agreed to by the family and the housing agency.

Such escrow payments are effectively counted as part of the costs the agency incurs for the family's voucher. Some housing agencies seeking to curb costs thus may stop enrolling new families in the FSS program. For example, the New Hampshire Housing Finance Agency has stopped admitting new families to its FSS program. The agency reports that the families in its voucher program with FSS escrow accounts have an average voucher cost that is 12 percent higher than the cost of vouchers used by other households.

Some Agencies Have Been Compelled to Cut Off Assistance to Current Voucher Holders

In many cases the measures listed above — each of which will result in significant hardship for low-income families — will be sufficient to enable agencies to make up the shortfall resulting from the new funding policy. Some agencies, however, face shortfalls so severe that they have no alternative but to terminate assistance for some families currently relying on a voucher to help pay the rent.[7] For example:

- The housing authority in the City of Alameda, California cut off Section 8 voucher assistance to 108 families at the end of June 2004. The city has used funds from other sources to extend housing subsidies for these families for another two months. But it is likely that those funds will run out at the end of August and the families then will lose assistance entirely if HUD does not provide additional funds.

- The housing agency in Pierce County, Washington, has notified 229 families that their vouchers will be terminated on September 1. The agency is asking local governments and religious organizations to provide funds to help the families pay the rent after that date.

- The housing authority in Elgin, Illinois has informed 32 families that their vouchers will be terminated on July 31 due to insufficient funds. Many of the families that are due to lose their vouchers are headed by people with disabilities. For example, one such family is headed by a quadriplegic mother caring for her two children.

[7] Some housing agencies have indicated that to avoid having to terminate current voucher holders, they will undertake cost-cutting measures that appear to be prohibited by voucher program rules (and that HUD has stated are illegal in its communications with housing agencies). For example, several agencies have said that they will reduce the rents that owners are permitted to charge on an across-the-board basis, without having any evidence that current rents are unreasonably high. Others have indicated they are planning to terminate only the vouchers of families that have moved to other jurisdictions.

- Despite adoption of a broad range of cost-cutting measures to reduce the approximately $62 per-voucher-per-month gap between its costs and the funding level that it is receiving under the new HUD policy, without additional HUD funds the Tacoma Housing Authority in Washington may have to terminate voucher assistance for 375 families as a last resort.

Without the rental assistance that vouchers provide, many of the families that lose vouchers will have to divert scarce resources from basic needs such as food, child care, and clothing for school or work to pay the rent. Others likely will no longer be able to afford their current apartments and be forced to relocate to overcrowded or substandard housing and could, in some cases, end up in homeless shelters or on the street.

Table 1
Impacts of HUD Funding Policy

Action to Reduce Voucher Costs in Response to Policy	Percent of Housing Agencies Implementing or Considering Action	
	Of All Housing Agencies Implementing or Considering Any Action	Of Non-Overleased Housing Agencies Implementing or Considering Any Action
Terminating Vouchers	12	10
Taking Back Vouchers from Searchers	15	16
Freezing Voucher Issuance	50	51
Refusing to Allow Portability	43	42
Lowering Payment Standards	64	66
Establishing or Increasing Minimum Rents	49	51
Recalculating Rent Reasonableness	20	16
Other Rent Reductions to Owners	20	22
Canceling or Reducing Project-Based Vouchers	5	3

Based on CBPP survey distributed to hundreds of housing agencies and advocates. To date, CBPP has received responses concerning a total of 117 PHAs. Ninety-two reported that they have made or are planning to make policy changes to reduce voucher costs due to the funding changes. Of these PHAs, 79 are leasing no more than the number of vouchers they are authorized to administer. Of the 13 PHAs that have made or are planning to make policy changes and that are leasing more than the number of vouchers they are authorized to administer, twelve are facing a funding shortfall due to the recent funding changes. The 92 PHAs combined administer 176,049 vouchers. The responses above were not taken from a random sample and are representative of all PHAs. Rather, they are intended to show the range of measures that PHAs might have to implement and how some PHAs are addressing the shortfall of funding.

HUD officials have suggested that the agencies that are imposing cuts are mainly agencies that have allowed families to use more vouchers than the agency is authorized to administer, and therefore must reduce the number of families assisted down to the authorized level. The available evidence indicates, however, that overleasing is not a primary reason for the cuts that are now occurring; many agencies that have not “overleased” in this manner are being compelled to impose cuts. Of the 92 agencies that reported in the recent CBPP survey that they were scaling back their programs in response to HUD’s policy, only 13 indicated that they had more vouchers in use during their then-current fiscal year than they were authorized to administer.[8] The agencies cited as examples in this paper took the actions described here as a result of HUD's policy for funding vouchers based on May-July 2004 per-voucher costs, not as a result of overleasing.

Perhaps in recognition of the fact that many agencies will not be able to close the gap between their current voucher costs and HUD's new funding level through these measures alone, HUD is altering various policies to make it easier for agencies to meet funding shortfalls by reducing the number of families receiving voucher assistance and by shifting additional rent burdens to tenants. These changes make clear that HUD's policy cannot be implemented solely or primarily by eliminating "excess" costs in the voucher program.

- On June 11, HUD issued a notice advising agencies that if they reduce the number of vouchers that are in use below the average number of vouchers that were in use in May-July 2003, the agency will still receive funding for its May-July 2003 number of units, if needed. This floor on the number of units that are funded is likely to encourage agencies that face large shortfalls to carry out a substantial portion of the required cuts by reducing the number of families served (i.e., by shelving vouchers as they become available or by terminating current vouchers), since reductions in the number of families served will not reduce further the amount of funding the agency receives.[9]

- On June 10, HUD staff advised groups representing housing agencies that HUD would publish a notice making an emergency revision in HUD regulations to allow reductions in maximum voucher rents to take effect with only 30 days notice for families currently using vouchers. This would replace an existing rule

[8] Even some of these 13 agencies may no longer be overleased, because their fiscal years end on June 30 and their survey only indicated that they were overleased on average during the year ending June 30, 2004. It would be expected that by the end of June many such agencies would have reduced the number of their vouchers that are in use below their authorized level, so any further cuts made by these agencies would result from HUD's policy of funding vouchers based on May-July per-unit costs.

[9] See Financial Management Center Bulletin #03-04, amending Bulletin #02-04 issued two days earlier. Had HUD not put this floor in place and instead simply funded agencies based on the number of vouchers in use according to the most recent available data (which could be as little as two months old), agencies would have faced strong incentives *against* reducing the number of families served. Under such a policy, a reduction in the number of families served would have pushed the agency into a downward spiral, in which a cut made in response to the reduction in funding would have resulted in a further reduction in funding, which in turn would have forced further cuts. Prior to HUD issuance of Bulletin #03-04 it appeared that HUD would implement a "floorless" policy of this type. HUD's April 22 notice states that HUD "will use the latest data provided by each PHA in [quarterly data submissions] to calculate unit months leased for the PHA fiscal year, which affects the PHA's renewal funding every quarter."

Even with the existence of a floor under the number of vouchers funded, agencies have some incentive to lease a greater number of units. Agencies that increase utilization may receive more administrative fees, since those fees are allocated based on the number of vouchers leased. (On June 14, HUD staff informed PHAs during a national information session on the new funding policies that there was no guarantee that they would receive additional fees if they leased more vouchers than they had leased in April 2004; receipt of additional fees above the April level would depend on a later HUD determination of whether sufficient funds were available.) In addition, if an agency raises the number of vouchers in use above the May-July 2003 level, it will receive additional funding for the added units; in other words, the May-July utilization level does not act as a ceiling on the number of vouchers funded.

> that delays for one to two years the effect of a maximum rent reduction on current voucher holders who stay in the same apartment. The elimination of this "grace period" would subject families to the harmful consequence of maximum rent reductions described above — including in some cases higher rent burdens, displacement from the family's home, and loss of the family's voucher — but with little time to adjust and make alternative arrangements.
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> In addition, it is likely that in order to implement a maximum rent reduction for current tenants, housing agencies would need to break their subsidy contracts with landlords and then offer to enter into a new contract at the lower maximum rent. Some landlords may take advantage of this break to end their participation in the voucher program, particularly if they are skeptical that tenants can cover their increased rental obligations or if they are concerned that subsidy payments under the voucher program have become unreliable.
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> HUD has not yet carried out the planned emergency revision to the regulations in the month since it indicated its intention to do so, so it is possible that the department has altered its plans. HUD staff have, however, indicated to some housing agencies that it will waive the grace period in individual cases (or otherwise allow agencies to sidestep the rule) to enable agencies to cut expenditures more rapidly. If a large number of agencies are permitted to bypass the rule in these ways, the effect could be nearly the same as if the regulations had been revised.

The damage caused by these reductions in voucher assistance will extend beyond the immediate hardship that low-income families experience. Many of the cost-reduction steps that agencies may take will either cause a direct financial loss to landlords who rent to voucher holders or increase the risk that landlords will be forced to initiate costly eviction proceedings against families with vouchers. Many landlords may become reluctant to rent to voucher holders in the future, making it more difficult for families who are issued vouchers to use them.

Several communities already report negative responses by owners as a result of HUD's actions. For example, the local owners association in Brockton, Massachusetts recently advised its members to stop renting to families with housing vouchers. Owners in Quincy, Massachusetts and Roseville, California have responded to the uncertainty about whether the agencies will have the funds to pay the rents that are owed by indicating they will not renew families' leases. In some cases, these owners have begun eviction proceedings

At the encouragement of Congress and HUD, housing agencies have worked successfully in recent years to build relationships with landlords and to increase the proportion of vouchers that are in use. HUD's new policy may undo years of hard work. The uncertainty that HUD has created about future voucher funding also is likely to deter lenders and underwriters from relying on the availability of Section 8 funding when approving loans or other investments, which may increase the costs of developing and operating rental housing for low- and moderate-income families. In addition, banks may no longer be willing to count on voucher subsidies to pay part of families' mortgage obligations, undermining the Section 8 homeownership program that the Administration has touted as one of the centerpieces of its housing policies.

Appeal Process Ignores Most Causes of Shortfalls and May Be Too Slow to Avert Cuts

HUD's April 22 notice states that a housing agency may appeal the inflation adjustments HUD uses to determine the agency's funding level. It is not clear, however, that such appeals will provide meaningful relief to most agencies that need additional funding.

Agencies were permitted to submit appeals up until July 15, 2004, and HUD has indicated that it will respond to appeals by August 31. If, as appears likely, HUD does not respond to appeals *until* that date or shortly before, many agencies will have no alternative but to adopt policies reducing voucher assistance before their appeals are ruled on. As discussed above, many agencies — aware that they will be forced to cut voucher assistance more deeply if they wait longer to initiate cuts — have already begun scaling back their programs.

HUD has not clearly laid out the criteria that agencies may use to make an appeal. Initially, HUD officials indicated that the only grounds for appeal would be evidence that recent growth in local rent and utility costs exceeds the HUD inflation factor. This needs to be an allowable basis for appeal because the regional rent inflation index (called the "Section 8 Annual Adjustment Factor" or AAF) that HUD is using to establish each agency's funding level encompasses large regions and often does not accurately reflect local market conditions. The AAF index divides the entire country into 116 regions. For example, it groups together every rural county in Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming into a single region. It also treats every metropolitan area in these six states (except for the greater Denver area) as a single region. Local housing markets, and the rates at which rental costs increase in those markets, can vary widely within these "regions."

Local housing cost inflation, however, constitutes only one of a number of legitimate reasons why HUD's inflation factors may be inadequate for many agencies. On June 25, 2004 — just three weeks before the deadline for submitting appeals — HUD released a guidance document on the appeals process stating that an agency could also appeal on the grounds that its costs rose because voucher holders moved to higher cost areas outside an agency's jurisdiction[10] and based on "other relevant factors." This allows HUD the flexibility to grant appeals based on any legitimate cost increase, but given the earlier statements by HUD officials indicating that the grounds for appeal will be very narrow there is no certainty that the department will do so.

A number of local circumstances beyond those mentioned in the June 25 guidance can cause an agency's actual cost per voucher in fiscal year 2004 to be significantly higher (or significantly lower) than the amount that HUD will provide to the agency under the new policy. For example:

- **Trends in family incomes will influence voucher costs.** The HUD inflation adjustment considers only changes in rents, not changes in the incomes of families with vouchers. But voucher costs are determined by the difference

[10] The HUD guidance also lists as criteria three specific factors that could cause rents in an area to rise more rapidly than the AAF: property tax increases, rent stabilization laws and other local rent requirements, and increases in property insurance rates.

between the rent of a modest cost unit and 30 percent of a family's adjusted income. If incomes in a local area decline or grow less rapidly than rents, average voucher costs will increase faster than the HUD formula predicts. The HUD formula is likely to be particularly damaging to areas where the local economy has performed poorly since last summer and incomes have stagnated. In Washington State, for example, the average annual income of families in the Pierce County Housing Authority's voucher program fell by $800 during the past year as the area's economy was hit by closings of an aerospace factory and other local employers. The decline in tenant incomes was a major reason why the agency's costs rose more rapidly than HUD's formula allows. Sixty percent of the agencies responding to the CBPP survey that reported higher current voucher costs than HUD's funding formula allows indicated that their costs had increased in part due to decreasing tenant incomes.

As the table below demonstrates, in a community that experiences a rent increase of 2.9 percent (the national average rental inflation rate in calendar year 2003), the cost of a typical voucher could grow by more or less than 2.9 percent, depending on changes in the incomes of families in the program.[11]

Rent Increase	Income Change	Cost Increase
2.9%	-2.0%	7.2%
2.9%	-1.0%	6.3%
2.9%	0.0%	5.4%
2.9%	1.0%	4.4%
2.9%	2.0%	3.5%
2.9%	3.0%	2.6%
2.9%	4.0%	1.7%

- **New vouchers that replace subsidies provided under other federal housing programs often have higher costs than existing vouchers.** When owners of federally subsidized apartment buildings decide to stop accepting federal project-based subsidies and to raise rents for units in their buildings, low-income tenants who reside in these buildings — most of whom are elderly or people with disabilities — can face displacement from their homes. To prevent that from occurring, Congress has established rules under which tenants in these buildings can receive a special type of voucher that covers the higher rents. Accordingly, these vouchers have higher costs than other vouchers. If a number of owners in a local agency's jurisdiction have recently opted out of federal project-based subsidies, the average cost of an agency's vouchers may have risen by considerably more than HUD's inflation factor.[12]

[11] The table shows the variation in the growth of the cost of a voucher used by a non-elderly, non-disabled family that has two children and initial income of $12,000 and lives in a housing unit with a monthly rent of $600.

[12] For example, one agency in New York City reports that its average monthly cost for these special vouchers is $1,653, about three times the average monthly cost of the agency's other vouchers. During the first year after it is issued, an "enhanced voucher" is supported with funds from a separate appropriation that is not considered part of

- **Families may move with their vouchers to neighborhoods with higher costs.** An agency's costs may increase if families with vouchers move from neighborhoods with very low rents to neighborhoods with somewhat higher rents. Such moves can enable families to escape from areas with high concentrations of poverty, high crime rates, and few educational or employment opportunities.

  HUD's June 25 guidance says that agencies can appeal for funding increases if their costs rise because families move to areas outside the agency's jurisdiction where costs are higher. (Under the voucher program, families are permitted to move with their vouchers to any community in the nation where there is a voucher program. In some cases, the agency that issues a voucher to a family continues to be responsible for covering the costs of the voucher after the family has moved to a different community.) But it does not specifically allow for appeals if cost increases result from moves *within* an agency's jurisdiction.

  Agencies that serve broad geographical areas are especially likely to experience shifts of this type. From August 2003 to June 2004, for example, 43 of the families receiving voucher assistance from the New Hampshire Housing Finance Agency shifted from non-metropolitan areas of the state to metropolitan areas, where the average voucher cost is 48 percent higher.

- **Local agencies may have made policy choices that caused voucher costs to rise *before* HUD adopted its new funding policy.** Some local housing agencies may have decided over the past year to target more vouchers on households with very little income, such as homeless families. Others may have increased the maximum amount of rent that vouchers may cover to enable more voucher holders to use their vouchers successfully, rather than to turn the vouchers back because they cannot find a landlord who will rent them a unit they can afford with their vouchers. Such policy changes could result in an agency's average voucher costs rising in fiscal year 2004 by more than the HUD inflation factor.

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an agency's voucher renewal funding and is not governed by the April 22 notice. Agencies that are currently issuing new enhanced vouchers thus will not experience shortfalls immediately as a result of the high cost of these vouchers. Instead, it will be agencies that issued enhanced vouchers after the May – July 2003 period that is used to determine an agency's average costs per voucher that will face shortfalls as the separate funding for these vouchers expires later this year and the vouchers become part of the agency's overall voucher renewals.

Such "opt-out" vouchers may increase an agency's average costs even if the rents paid are not unusually high. For example, effective August 1, 2003, the Iowa City Housing Authority received new vouchers for tenants in a development that had opted out of the project-based section 8 program. Because of the timing of the award, none of these vouchers is included in the agency's reported costs for May - July 2003. The average voucher payment for these families is 38.5 percent higher than the "frozen" cost figure that HUD is using to fund Iowa City, primarily because most of these households are families with children that needed larger, and therefore more expensive, units than the smaller households the agency typically had previously served.

Recent HUD Actions Only Partially Address Flaws in Funding Method

On May 20, 2004, HUD Secretary Jackson announced two steps intended to "alleviate" the funding difficulties stemming from the policy set forth in the April 22 notice.

- **HUD is setting funding levels based on the full 2004 Annual Adjustment Factor**. Prior to Secretary Jackson's announcement, HUD set voucher funding levels based on adjusting the May – July 2003 average voucher cost only by a fraction of the Annual Adjustment Factor for 2004. HUD's partial inflation adjustment method, which was inequitable and was never explained, would have resulted in significantly lower funding levels for many agencies.[13]

- **HUD made available $152 million in funds to replenish program reserves.** Before fiscal year 2003, HUD provided each housing agency with program reserves equal to one-twelfth of the agency's annual funding and replenished these reserves at the end of the fiscal year (or during the fiscal year under some circumstances). It appears that HUD did not follow this practice in 2003. This $152 million will be used to partially replenish reserves, which can then be used to cover shortfalls in voucher funding.[14]

These two steps will reduce the harm resulting from HUD's funding policy to some degree. They are insufficient, however, to avoid cuts in voucher assistance. As discussed above, even funding levels set using the full Annual Adjustment Factor will be inadequate for many agencies. Furthermore, for several reasons, the added program reserves will offer only a limited solution to the flaws in the April 22 HUD policy.

- **The amount of added reserve funds is too low to cover the shortfalls faced by some agencies.** HUD officials have said that HUD used the $152 million to replenish each eligible agency's reserves to *half* of the full reserve level. This amounts to about 4 percent of an agency's estimated annual costs in 2004. However, some agencies report that the reserve funding HUD has now provided them does *not* restore their revenues to half of the normal reserve level. HUD has

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[13]HUD has characterized the formula used prior to Secretary Jackson's announcement as a "pro-rated" adjustment, but in fact it was simply inadequate. HUD's Annual Adjustment Factor is intended to reflect the percentage increase in rental charges over a 12-month period. Properly "pro-rating" this factor for a period shorter than twelve months would mean adjusting it so it covers the correct number of months. For example, to adjust costs from the May-July 2003 base period that HUD is using to the January-March 2004 period, HUD would need to apply eight months worth of inflation adjustment (since January is eight months after May). Before Secretary Jackson's announcement, however, HUD was applying *only three months* worth of inflation adjustment for the period from May-July 2003 to January-March 2004.

[14] The $152 million that would be used to replenish reserves consists of unspent funds appropriated by Congress for the voucher program's "central fund," which is available to help support voucher renewals. Under the HUD policy in place in fiscal year 2003, HUD already should have used these funds to replenish reserves. (PIH 2003-23, the HUD notice establishing the voucher funding method for fiscal year 2003, states that "If appropriations are available, HUD intends to annually restore ACC reserves to the one-month level.") HUD has not explained why it did not follow this policy in 2003.

provided no explanation of the apparent discrepancy. Even if HUD did replenish each agency's reserves to half of the full level, some agencies face shortfalls that exceed 4 percent of their estimated 2004 costs and thus are too large to be closed with the replenished reserves.

- Many housing agencies will be reluctant to use reserve funds to cover the gap between the amount of funding they have received from HUD and actual voucher costs, because at times HUD has indicated that such reserves will not be replenished in the future. HUD initially stated that if a housing agency uses its reserve funds to cover shortfalls that occurred because the per-unit funding level provided to the agency under the April 22 notice is lower than the agency's actual costs, the fiscal year 2004 appropriations law prohibits HUD from replenishing that agency's reserves in the future. This interpretation does not appear to be supported by the language of the appropriations law,[15] and recent HUD documents discussing replenishment of reserves appear to back away from it. Nonetheless, it is likely that the uncertainty created by HUD's inconsistent statements on this topic will make some housing agencies reluctant to use reserves to cover shortfalls resulting from HUD's April 22 policy.

  And even if reserves used to cover such shortfalls are eligible for replenishment, an agency cannot be confident that HUD actually will replenish them. HUD has replenished reserves only inconsistently in recent years, and it has explicitly stated that agencies cannot rely on replenishment of reserves in fiscal year 2004 because HUD may not have sufficient funds. Already, a number of agencies with sufficient reserve funds to cover this year's funding shortfall — particularly in cases where funding the shortfall can be met without terminating vouchers that families are currently using — have chosen to impose significant cuts in voucher assistance rather than deplete their reserves, out of concern that they will face a permanent reduction in reserve levels available to meet future unforeseen funding needs.

[15] HUD has claimed that it is unable to replenish reserves used to cover cost increases because the fiscal year 2004 appropriations act prohibits the use of the "central fund" to cover cost increases. This claim is dubious. The central fund represents a portion of the appropriation for the voucher program that Congress has set aside to serve as a reserve for agencies that increase the number of authorized vouchers in use during their fiscal year. Under previous HUD policy, the Department could use the main voucher renewal appropriation, which is separate from the central fund, to replenish reserves. *Nothing in the fiscal year 2004 appropriations act requires HUD to change this policy*. The prohibition in the 2004 act on using funds to cover cost increases applies only to the central fund. In other words, HUD can use the main voucher renewal fund to replenish reserves drawn down to defray increases in per-voucher costs but is choosing not to do so.

Moreover, HUD can use unspent funds from previous years to replenish reserves. Senator Christopher Bond, the chair of the Senate Appropriations Subcommittee with jurisdiction over HUD, noted that prior-year funds can be used in this manner in an April 29 letter to Secretary Jackson.

HUD Has the Fiscal and Legal Authority to Avoid Cuts in Voucher Assistance

HUD has stated that the fiscal year 2004 appropriations act leaves it no choice but to provide voucher funding in the manner described in the April 22 notice — and therefore to force cuts in voucher assistance. This interpretation is not shared consistently by key members of Congress who were involved in drafting the bill.

Representative James Walsh, the chair of the House Appropriations subcommittee with jurisdiction over HUD, released a May 4 letter to other members of the House that was supportive of HUD's policy. In an April 29 letter to Secretary Jackson, however, Senator Christopher Bond, the chair of the Senate Appropriations subcommittee that has jurisdiction over HUD, took a different view. Senator Bond supported some aspects of the April 22 notice but pointed out that HUD's policy fails to make use of its authority under the 2004 appropriations law to take into account data on *actual* rents and incomes in a PHA's program after May-July 2003 to set funding levels. Senator Bond also emphasized that HUD has the authority to use the central fund to prevent shortfalls in funding due to decreased tenant contributions as a result of lost income, and to use carryover funds to replenish reserves used to cover voucher cost increases that exceed HUD's inflation adjustment.

Senator Barbara Mikulski, the ranking minority member of the same subcommittee, wrote in a stinging April 21, 2004 letter to Secretary Jackson that she was "shocked" by HUD's "unacceptable" implementation of the fiscal year 2004 appropriations act. Her letter also states that "The Department clearly has the authority to provide housing authorities with the funds they need to serve all families in the Section 8 program."

The language of the 2004 appropriations act itself supports the argument that HUD has the authority to provide funding for all vouchers in use at their actual cost. This act did make some changes in the details of the voucher funding structure, and the conference report accompanying the act directed HUD to report to Congress by July 31, 2004, on the reasons for recent increases in average voucher costs and to *recommend* possible policy changes. But nothing in the appropriations statute requires HUD to cap funding for vouchers in a way that leaves some vouchers now in use unfunded.

Language of Fiscal Year 2004 Appropriations Bill Appears to Require Funding for Vouchers at their Actual Cost

The language of the fiscal year 2004 appropriations act appears to continue the fiscal year 2003 policy of requiring HUD to provide voucher renewal funds based on the best available data on agencies' *current* actual costs. The clause in the act relating to voucher renewals calls for HUD to provide funding for renewals based on "actual costs" and is virtually identical to the language in the fiscal year 2003 appropriations act. The only difference is that the fiscal year 2004 legislation omits the specification that per-voucher costs are to be determined based on a housing agency's most recent fiscal year-end statement, This change was apparently made in recognition of the fact that in the last year, HUD has developed a quarterly reporting system for voucher cost data and no longer bases costs on the most recent year-end statement.

The fiscal year 2004 appropriations act does limit the use of voucher renewal funds to the *number* of authorized vouchers under lease on August 1, 2003. But it does *not* impose a retroactive limitation on *per-voucher costs* or limit such costs to per-voucher costs in August 2003, adjusted only by a regional inflation factor.

The conference report accompanying the fiscal year 2004 appropriations act supports the interpretation that the conferees did *not* intend to bar funding for an agency's increases in *per-voucher costs*, while they clearly did bar use of funds from the main voucher renewal appropriation for increases in the *number* of vouchers in use. The report indicates that the main renewal fund would be sufficient to cover increases in per-voucher costs in fiscal year 2004, so there would be no need for HUD to use the voucher program's central fund for this purpose. The conference report notes that the act no longer allows housing agencies to draw on the central fund when voucher costs increase "as such costs have been reflected in the amount provided for renewals." By contrast he act does permit agencies to draw on the central fund to cover increases in costs resulting from an increase in the number of authorized vouchers in use.

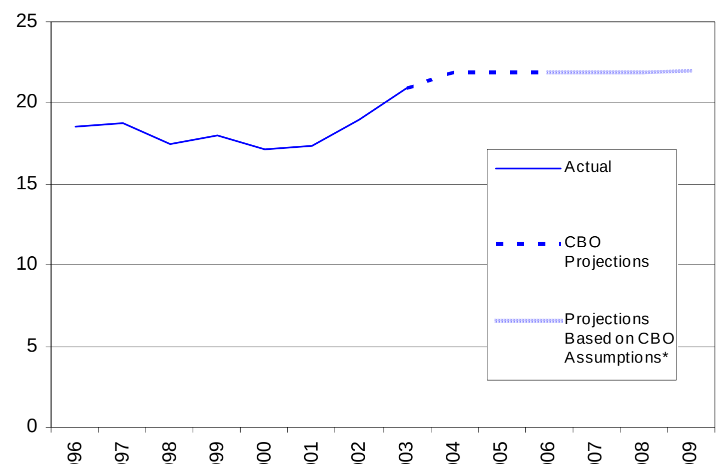
In fact, as is discussed in the text box above, the language in the bill regarding the most problematic aspect of HUD's policy — the determination of the per-voucher cost that is used to set the amount of renewal funding provided to each housing agency — is essentially the same as in the previous year's appropriations act. HUD interpreted that act to allow it to use the most recent available cost data to set funding levels, an approach that functioned effectively last year and would have averted the sharp cuts now occurring if HUD had continued to follow that policy.

Moreover, Congress provided HUD with *substantially more money than will be used under HUD's restrictive new policy*. The House-Senate conference committee that drafted the final version of the fiscal year 2004 appropriations law provided the amount of funding for vouchers that it did — which was more than $1 billion above both HUD's original request and the amounts approved earlier last year by the House and Senate — because HUD estimated during the conference deliberations that this higher amount represented the amount needed to support all vouchers likely to be in use. Indeed, Congressional appropriators used an estimate by

HUD that the average cost of a voucher in fiscal year 2004 would be $6,432. Under HUD's new policy, however, the average funding HUD is providing per voucher is only $6,309.[16]

HUD has stated that it will have about $190 million available beyond the amount that will be provided to agencies under the new funding formula. CBPP estimates indicate that the actual amount available could be substantially higher.[17] HUD has indicated that these funds will be available to agencies that successfully appeal their funding allocations. Unless HUD allows appeals on much broader grounds than it thus far has indicated will be allowed, however, it is likely that much of this amount will be left unspent even as agencies with shortfalls that result from legitimate cost increases cut assistance for needy families. It appears that this $190 million, together with the funds in agency program reserves, would be sufficient to support all vouchers in use.

Figure 1: Inflation-Adjusted Section 8 Outlays*
in billions of dollars



Nor is the new HUD policy necessary to meet concerns that Congress has expressed about growth in voucher costs. Per-voucher costs have risen sharply in the last few years, but this increase will slow considerably even *without* HUD's harsh new funding policy. Most of the increase in per-voucher costs in the last five years was caused by the fact that market rents were rising faster than the incomes of low-income

[16] Both of these figures exclude Section 8 Moderate Rehabilitation units and vouchers administered by certain agencies participating in the Moving-to-Work demonstration; these two categories of subsidies have traditionally been funded through separate mechanisms.

[17] Estimates by CBPP indicate that the excess funding would be higher — approximately $260 million. This is the approximate amount by which the funding provided under the policy that HUD announced on April 22 will fall below the fiscal year 2004 appropriations level for voucher renewals, including the central fund, assuming that the number of vouchers leased continues at the level achieved in January 2004. This estimate is probably conservative, since it does not assume any reductions in the number of vouchers in use beyond those directly resulting from funding shortfalls created by HUD's policy. It is likely that some agencies will reduce the size of their voucher programs even more than they are required to, out of concern that they will receive inadequate funding in the future. In addition, the estimate of $260 million assumes that HUD will permit agencies to use all of their federal fiscal year 2004 funds at any point in calendar year 2004, regardless of whether an agency's fiscal year ends in June or September rather than December.

[*] Outlays in Figure 1 are in constant 2003 dollars, adjusted using the CPI. Outlay levels for fiscal years 2004 through 2006 are CBO projections from the March 2004 baseline. In 2007 through 2009, the chart shows the amount of outlays required to support all authorized Section 8 units that will require funding under CBO assumptions regarding the number of authorized units, per-units costs, and the voucher utilization rate. Because of technical, statutory constraints on the methods CBO uses to project total Section 8 outlays, CBO's actual outlay projections in those years are below the level required to support all of the authorized units that will require funding. As a result, CBO's actual projections are somewhat below the adjusted levels shown in the figure.

families.[18] The increase in rents has now begun to slow, however, while income growth should accelerate as the economy recovers. These two trends should combine to keep per-voucher costs in check in coming years.

Indeed, the Congressional Budget Office estimates that the average cost of a housing voucher will rise only 2.9 percent in fiscal year 2005, well below the rate of increase in recent years. CBO projects that overall spending under the Section 8 program, which includes both the housing voucher program and a separate project-based housing assistance program, will grow by only 1.8 percent in 2005. As Figure 1 shows, when inflation is taken into account, overall spending on vouchers is expected to be nearly flat in the coming years. For further discussion of the explanation for recent cost increases, see "The Myth of Spiraling Voucher Costs" available on the internet at http://www.centeronbudget.org/6-11-04hous.htm.

Steps HUD Can Take to Mitigate or Prevent Voucher Cuts

Under the terms of the fiscal year 2004 appropriations law, HUD can avert further housing assistance cuts by providing funding based on agencies' actual costs, as reflected in the latest available data. Even without taking such action, HUD has several options available to it that would sharply reduce the harm that its new policy otherwise will cause. HUD can:

- Allow all legitimate bases for cost increases — including reductions in tenant incomes — as a basis for filing an appeal for a funding adjustment, rather than limiting the bases for appeals to cost increases that result from local housing cost inflation exceeding the inflation factor that HUD adopted, and a small number of other factors. If HUD does consider grounds for appeal beyond the limited list of factors it has enumerated so far, it should also allow agencies to submit additional appeals after the July 15 deadline. Some agencies may have opted not to submit appeals based on other factors in the belief that they would not be considered. Such an extension should not, however, alter HUD's commitment to evaluate by the end of August appeals submitted before the July 15 deadline.

- Allow agencies until December 31, 2004 to make up "overpayments" that occurred before HUD announced its new policy, regardless of the date on which an agency's fiscal year ends. Such a step would help compensate for HUD's tardiness in waiting until April 22 to release its novel interpretation of the fiscal year appropriations law.

- Make clear that if sufficient funds are available in the future, HUD will replenish agency program reserves that have been drawn down to cover legitimate increases in average costs per voucher on the same basis that it uses to replenish reserves drawn down to cover increases in the number of authorized vouchers in use.

HUD has sufficient fiscal and legal authority to take all of these steps.

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[18] See Barbara Sard and Will Fischer, "Nearly All Recent Section 8 Growth Results from Rising Housing Costs and Congressional Decisions to Serve More Needy Families," Center on Budget and Policy Priorities, February 2, 2004, available on the internet at http://www.centeronbudget.org/2-2-04hous.htm.