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## **PRESIDENT'S 2007 BUDGET RENEWS SAME NUMBER OF HOUSING VOUCHERS FUNDED IN 2006 But Many Local Programs Could Face Cuts Due to Flawed Funding Formula**

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### **Executive Summary**

The President's budget requests \$15.9 billion in fiscal year 2007 for tenant-based rental assistance under the Housing Choice Voucher Program, the nation's largest low-income housing program. The request would renew approximately 2,070,000 vouchers in 2007, about equal to the total number of vouchers funded in 2006. Yet most local communities would face cuts due to the inefficient method that would be used to allocate funds among the more than 2,400 state and local housing agencies that administer the program.

The budget proposes to distribute voucher renewal funding using a formula similar to the "dollar-based" formula implemented in 2006. Under this formula, the share of funding that each housing agency receives is based on the amount it was eligible to receive the previous year, adjusted by an inflation factor set by HUD. The HUD inflation factor would be derived from housing cost data that is two years out-of-date, and no adjustments would be made for the number of vouchers that an agency uses or changes in the actual per-voucher costs in the area that the agency serves.

### **KEY FINDINGS**

- **The President's 2007 budget request would renew approximately 2.07 million vouchers, about the same number funded in 2006.**
- **The budget would use a flawed formula to distribute voucher funding that would have widely disparate effects on agencies. Because they would receive an inadequate share of funding, one-quarter of all agencies would be able to use less than 90 percent of their authorized vouchers.**
- **The budget proposes a major shift in policy that would reduce the voucher assistance available to communities where public or project-based housing has been demolished or otherwise lost.**
- **The budget request sets aside up to \$100 million in voucher funding for the important purpose of protecting the right of voucher holders to move to communities that better meet their needs (as well as other purposes). These funds also may be needed to meet hurricane-related voucher costs.**
- **Since early 2004, voucher assistance for more than 100,000 families has been lost.**

This distribution formula, in combination with the renewal funding level requested, would fail to provide the funding stability that state and local housing agencies badly need. We estimate that the budget request would *underfund 70 percent of agencies* in 2007, forcing them to cut the number of families they serve or reduce the average rent subsidy they provide to each family, which would raise rent burdens on needy families or have other harmful consequences. At the same time, about one quarter of agencies would receive sufficient funding to lease up *more* vouchers in 2007 than they could in 2006.

The budget would result in state and local agencies being able to use widely disparate shares of their authorized vouchers. For individual agencies, the percentage of authorized vouchers that would be funded would vary from less than 60 percent in some agencies to more than 140 percent of authorized vouchers in others. Because they would receive an inadequate share of funding, one-quarter of all agencies would be able to use less than 90 percent of their authorized vouchers, while a slightly larger percentage of agencies would be funded for at least the full number of vouchers they currently are authorized to administer.

Since early 2004, the combined effect of the use of inefficient formulas to distribute voucher renewal funding, poor implementation of voucher funding policy by HUD, and voucher funding shortfalls has been to generate fiscal instability among state and local housing agencies and cause a significant reduction in the number of families assisted under the program. According to recent HUD data, between April 2004 and September 2005, the number of families assisted by vouchers fell by about 60,000, even as roughly 40,000 families being shifted from other forms of housing assistance were issued new “tenant-protection” vouchers during this period.<sup>1</sup> This means that the number of families assisted fell by about 100,000 over this 17-month period, once adjustment is made for families that were shifted from other housing assistance to a voucher. This represents a substantial loss at a time when many communities have long and growing waiting lists for voucher assistance.

HUD and other supporters of the “dollar-based” formula now being used to allocate voucher funding have argued that it will engender fiscal predictability and stability in the voucher program. The evidence indicates, however, that the opposite has been the case — the funding levels received by state and local housing agencies under the dollar-based formula have been more unpredictable and less stable.

Since the current dollar-based formula was first introduced in 2005, the Administration has not requested, nor has Congress provided, full funding for the formula. As a result, the funding level for each state and local housing agency has been prorated (i.e., reduced below the amount for which the agency is eligible under the formula) each year. In 2005 and 2006, funding due under the formula was cut by 4.1 and 5.4 percent, respectively. According to our estimates, these reductions are likely to be followed by a pro-rata reduction of 6.7 percent in 2007, under the funding level the President’s budget requests. In other words, a pattern may be developing under which policymakers are providing a steadily decreasing share each year of the funding called for under HUD’s own formula. The funding that housing agencies received stood at 95.9 percent of what the formula called for in

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<sup>1</sup> Tenant-protection vouchers are issued to families whose existing housing assistance is ending because the public housing project in which they are living is being torn down or a federally subsidized, privately-owned building in which they reside is being converted to other uses.

2005, and 94.6 percent of what the formula called for in 2006. Under the President's budget, funding would equal an estimated 93.3 percent of what the formula calls for in 2007.

Deepening cuts in formula funding create substantial fiscal uncertainty and shortfalls for state and local housing agencies, making it difficult for them to manage their programs well. The dollar-based formula consequently has aggravated, rather than mitigated, the fiscal instability of housing agencies.

Rather than acknowledging that flawed funding formulas have contributed to the fiscal instability experienced by local voucher programs, the budget faults the existing rules of the voucher program for failing to give agencies sufficient flexibility to adjust to funding shifts. The Administration restates its intention to convert the program to a block grant and to eliminate current statutory protections that require most vouchers be used to serve poor families at rents they can afford. Filed last year, the Administration's block-grant proposal (the "State and Local Housing Flexibility Act") has so far not been favorably received by Congress.<sup>2</sup> Because the Congressional calendar is tight this year, major changes in the housing voucher program are unlikely to be enacted in 2006.

The budget would set aside \$100 million of the requested voucher renewal funds to be allocated by HUD for "unforeseen exigencies" and for payments to agencies to offset costs related to program provisions that allow families to use vouchers to move to new communities. Recent changes in the funding formula have compelled housing agencies to increasingly restrict the ability of voucher holders to move to communities with better jobs and schools, a trend that undermines one of the essential benefits of housing vouchers. The set-aside funds could play an important role in protecting voucher holders' right to use their vouchers to move to new areas. The \$100 million in funds also could be important in enabling Gulf Coast agencies to meet rapidly rising housing costs and in assisting communities that have taken in Gulf Coast evacuees, since the special disaster funds they are using to help evacuees will expire in 2007.

The budget request for tenant protection vouchers to replace federal housing assistance that has been eliminated — \$149 million — is nearly \$30 million below last year's appropriation for this purpose and would support about 5,000 fewer vouchers. In a major policy shift, the budget would limit the award of tenant protection vouchers to the replacement of subsidized units that were under lease at the time they were demolished or disposed of. In the past, tenant protection vouchers were generally provided to replace *all* subsidized units. This is because the vouchers are intended not just to help specific residents whose units had been eliminated, but also to compensate the community for the loss of affordable housing resources. As a result of the proposed change, communities where some units in a subsidized building are vacant at the time the subsidies are ended would permanently have fewer subsidies available to help low-income people afford housing.

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<sup>2</sup> The Administration's proposal was first introduced as S. 711 by Senator Wayne Allard (R-CO) on April 13, 2005. Representative Gary Miller (R-CA) introduced a similar bill as H.R. 1999 in the House on April 28, 2005. The House Financial Services Committee held two hearings on the House bill shortly after it was introduced; no hearings have been held in the Senate. For an analysis of the Administration's proposal, see Will Fischer and Barbara Sard, *Administration Housing Proposal Lays Groundwork For Planned Funding Reductions*, May 9, 2005, <http://www.cbpp.org/5-9-05hous.htm>.

On the whole, affordable housing and community development programs fare poorly in the 2007 budget request. The Administration proposes to cut total HUD funding in 2007 by 3.9 percent in real terms (i.e., below the 2006 levels, adjusted for inflation). Substantial cutbacks are sought for public housing, the Community Development Block Grant (CDBG), and new affordable housing for the elderly and people with disabilities. In many cases, the proposed cutbacks follow on funding cuts already implemented in prior years. At a time when many communities are struggling to meet severe affordable housing needs, the budget request would sharply reduce housing assistance to support these efforts. In addition, proposed cuts to popular programs such as CDBG are likely to place pressure on Congress to reduce funding elsewhere in the HUD budget, including funding for Section 8 vouchers, in order to restore funding to those programs.

### **Overview of the President's Request for the Housing Voucher Program**

The President's budget requests \$15.9 billion for the Section 8 Housing Choice Voucher Program in fiscal year 2007. This is an increase of \$502 million, or 3.3 percent, compared with the final appropriation for 2006 (after the one percent across-the-board cut enacted in December).

For renewal of existing housing vouchers, the budget requests a total of \$14.4 billion. Of this sum, \$14.3 billion would be distributed to state and local housing agencies under a formula similar to that used in 2005 and 2006. The remaining \$100 million would be reserved for certain voucher costs not covered by the funding formula.

We estimate that on a national basis, the budget would renew approximately 2,070,000 vouchers, the same total number of vouchers that can be used in 2006. But at the local level, the budget would not simply maintain the status quo. Because of inefficiencies in the formula for distributing voucher funds, many state and local housing agencies would have to make cuts in their voucher programs, while some agencies would be able to increase the number of vouchers they can use.

Some 70 percent of agencies would receive funding for fewer vouchers in 2007 than in 2006.<sup>3</sup> We estimate that these agencies will have to eliminate about 20,000 vouchers in 2007. At the same time, about a quarter of agencies would be able to increase the number of families they serve by roughly 20,000. This shift of 20,000 vouchers to different agencies is a function of the funding formula and does not reflect a determination of which areas most need vouchers; in fact, the areas that would lose vouchers generally need them more than the areas that would gain vouchers.

The budget also requests \$149 million for new "tenant protection" vouchers, which replace other types of federal housing assistance that has been eliminated. This is substantially less than the appropriation for such replacement vouchers in prior years, and would support about 5,000 fewer tenant protection vouchers than were funded in 2006 or awarded in 2005. Moreover, the budget

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<sup>3</sup> The Technical Appendix explains the bases of our estimates of the number of vouchers funded in 2006 and 2007. We have assumed that agencies' voucher costs grow at the rate projected in HUD's funding formula in 2006 and then at 2.7 percent in 2007. Blending assumptions about changes in market rents and tenant incomes, the Congressional Budget Office has estimated that average voucher costs would increase nationally by 2.7 percent from 2006 to 2007. Under the budget proposal, actual local changes in the number of vouchers funded will depend on the actual change in voucher costs — which may be more or less than the 2.7 percent we have assumed for all agencies — and the applicable HUD inflation factor.

proposes a policy change that would reduce the number of replacement vouchers awarded when communities lose other HUD-assisted housing.

The budget requests \$1.281 billion for administrative fees, of which \$1.251 billion would be distributed by formula based on each agency’s eligibility for administrative fees in 2006. Overall, this is an increase of \$43.6 million, or 3.5 percent, in administrative funding. Only about half of the increase would be distributed to all agencies through the administrative-fee formula; HUD would allocate the rest to agencies that receive additional tenant protection vouchers. As a result, most agencies would receive an administrative-fee increase of only 1.9 percent. As in each of the last three years, agencies’ administrative funding allocations would bear no relation to their performance in using their vouchers.

For coordinators for the Family Self-Sufficiency (FSS) program, the budget requests \$47.5 million, a small (\$20,000) decrease from the 2006 funding level. (FSS is HUD’s primary program to promote work and increase earnings among voucher recipients.<sup>4</sup> In 2005, FSS served about 73,000 families, mostly participants in the housing voucher program.<sup>5</sup>) While the budget does not request the additional funds needed to reverse previous cuts in the number of FSS program coordinators, it does propose a positive change in the funding formula that would remedy the existing disincentive for agencies to enroll families in FSS.

The following table compares the Administration’s request for the housing voucher program with the 2006 funding levels provided by Congress.

<b>TABLE 1</b>		
<b>HOUSING VOUCHER FUNDING</b>		
	<b>2006 Final</b>	<b>President’s FY07 Request</b>
<b>Voucher renewals</b>	\$13,948,858,168	\$14,436,200,000
<b>Formula allocation</b>	\$13,904,308,168	\$14,336,200,000
<b>Adjustment Fund</b>	\$44,550,000	\$100,000,000
<b>Tenant Protection vouchers</b>	\$178,200,000	\$149,300,000
<b>Administrative fees</b>	\$1,237,500,000	\$1,281,100,000
<b>Formula allocation</b>	\$1,227,600,000	\$1,251,100,000
<b>Family Self-Sufficiency Coordinators</b>	\$47,520,000	\$47,500,000
<b>Working Capital Fund transfers</b>	\$5,841,000	\$5,900,000
<b>Total tenant-based account</b>	<b>\$15,417,919,168</b>	<b>\$15,920,000,000</b>
<b>Rescission from Certificate Fund</b>	\$2,050,000,000	\$2,000,000,000

<sup>4</sup> FSS consists both of case management services that help participants pursue employment and other goals, and of escrow accounts into which the housing agency deposits the increased rental charges that a family pays as its earnings rise. Families that complete the program may withdraw funds from these accounts for any purpose after five years.

<sup>5</sup> Jeffrey Lubell and Reid Cramer, “Shoring Up HUD’s Family Self-Sufficiency Program: Recommendations for Congressional Action,” New America Foundation Issue Brief, September 2005, p. 2. This report and other information concerning the FSS program are available at [www.fsspartnerships.org](http://www.fsspartnerships.org). See text box on page 8.

## Voucher Renewal Request Will Not Provide Needed Stability in Local Programs

We estimate that the \$14.3 billion requested for the renewal of existing housing vouchers under the bill's formula would assist approximately 2,070,000 families in 2007, the same number of families that we estimate can be assisted in 2006. This is 95.6 percent of the 2,164,000 vouchers that Congress has authorized prior to 2007.<sup>6</sup> This is a substantial decrease from the 98.5 percent of vouchers that agencies used in the 12-month period ending June 30, 2004.<sup>7</sup>

Moreover, for individual agencies, the percentage of authorized vouchers that would be funded would vary greatly, from less than 60 percent to more than 140 percent. One-quarter of all agencies would receive funds insufficient to support more than 90 percent of their authorized vouchers, while a slightly larger number of agencies would be funded for at least the full number of vouchers they now are authorized to administer. State funding levels would vary widely as well: four states (California, New Hampshire, Utah and Vermont) would receive funding for all of their authorized vouchers, while in three states (Hawaii, Maryland and Rhode Island), 87 percent or fewer of authorized vouchers would be able to be used.<sup>8</sup> See Appendix 1 for state-level data.

This wide variation in the percentage of authorized vouchers that would be funded results from the formula used to allocate renewal funding, which the Administration has used since 2005 and proposes to use again (with minor changes) in 2007. Under the formula, each agency's voucher funding for 2007 would be based on the agency's voucher costs during the three-month period of May – July 2004, adjusted by annual inflation factors set by HUD. Because the formula is not recalibrated based on recent cost or leasing data, this funding approach is considered to be a “dollar-based” rather than a “unit-based” policy. (A “unit-based” policy is based on the cost of funding a particular number of vouchers.)

The formula's mid-2004 starting point is out of date. So is its inflation adjustment, which is based on two-year-old rent and utility data. As a result, agencies' funding allocations fail to reflect recent changes in local rental and related voucher costs. Yet there is no mechanism to shift resources to (or away from) agencies that have experienced substantial recent cost changes. Moreover, the decision to base the formula on the brief “snapshot” period of May – July 2004 deprives many agencies of funding for vouchers that were not in use during that period. (Congress in part

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<sup>6</sup> In most of the more than 30 years of the Section 8 tenant-based rental assistance program, Congress has appropriated funds for new, so-called “incremental” housing vouchers to increase the number of families receiving housing assistance. Since the mid-90s, Congress also has appropriated funds for additional vouchers to replace other types of federal housing assistance, such as public housing units that are demolished or privately-owned units that no longer receive federal subsidies. Each agency's current number of authorized vouchers is based on the awards of additional vouchers it has received over time. Generally, HUD has based awards on community need and agency performance.

<sup>7</sup> U.S. Department of Housing and Urban Development, *Performance and Accountability Report FY 2004*, p. 2-45.

<sup>8</sup> These figures include only housing agencies in the 50 states and the District of Columbia. They do not include Puerto Rico and the territories, where the funding rates appear anomalous. Even in states where agencies will be able to use the same number of vouchers that are authorized for use in that state, some agencies will receive insufficient funds to use five percent of more of their vouchers. In these states, however, these shortfalls are offset by other agencies receiving funding for more than their authorized number of vouchers.

recognized the arbitrariness of basing voucher funding in 2006 on voucher use in a three-month period in 2004, but provided inadequate funds to solve it.<sup>9</sup>)

The cumulative effect of all of these factors is that local funding allocations under the Administration's budget would diverge to varying degrees from the funding that each agency needs to use all of its vouchers. Because of the formula's inefficiency, communities with declining rental costs — such as the previously overheated rental markets in coastal California — would receive more funding than they can use to lease all of their authorized vouchers, while in other communities funding would not keep pace with rising costs.

### **Out-of-Date Funding Formula Would Cut Vouchers Funded at Most Agencies**

While the budget proposes some slight changes to the 2006 funding formula, those changes would not remedy the misallocation of resources that the formula has engendered. For example, the Administration proposes to allow housing agencies to lease more vouchers than they are currently authorized to lease. (For the last four years, Congress has barred this practice, known as “overleasing.”) For agencies that receive more funding than they need to renew all of their vouchers in use, this change would enable them to use the extra funds to support more vouchers. However, the change would do nothing to help agencies that are shortchanged by the funding formula.

At the funding level requested, we estimate that each agency would receive 6.7 percent less funding in 2007 than is called for by the funding formula. That shortfall is 1.3 percentage points greater than the 5.4-percent shortfall in 2006.<sup>10</sup> This means that agencies whose voucher costs rise no faster in 2006 and 2007 than allowed by the funding formula could not count on receiving the funding they would need to continue supporting the current number of vouchers in use. The steadily-deepening cuts in relation to the formula funding will likely result in reductions in the number of families receiving voucher assistance.

Only if an agency is able to limit the increase in voucher costs below HUD's inflation factors for 2006 and 2007 will it receive sufficient funding to operate a stable program. It is unlikely that more than a modest percentage of agencies can curb voucher costs to this extent without reducing the effectiveness of their programs. Cost-reduction policies adopted by many agencies in the last two years have already led many owners to drop out of the program (due to insufficient subsidy levels) and have made it harder for families to find housing with their vouchers. It is important to remember that the voucher program is market-driven: basic costs are outside of agencies' control, since they are based on private-sector rent and utility costs and on families' incomes. If agencies

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<sup>9</sup> In the 2006 appropriations act, Congress directed HUD to provide additional funds to agencies that used more vouchers in their 2004 fiscal year than in the three-month snapshot period, and set aside \$44.55 million for this purpose. (HUD also has discretion to use the set-aside for other limited purposes.) HUD has not yet announced how it will allocate these funds. HUD data indicate that 940 agencies had a higher rate of voucher use in their 12-month fiscal year than in May–July 2004, and could qualify for a funding adjustment on this basis. We estimate that the full cost of this adjustment would be \$97 million in 2006. See the Technical Appendix.

<sup>10</sup> In other words, under the proposed budget, in 2007 agencies would receive 93.3 percent of the funding due them under the formula. (This estimate assumes that the national average inflation adjustment in 2007 would be 2.7 percent. If this estimate is low, the proration would be deeper. In the last two years, HUD's inflation adjustments have averaged 3.4 percent (2005) and 3.2 percent (2006).) In late February, HUD notified agencies that in 2006, they will receive 94.599 percent of their full formula funding. The proration in 2006 is deeper than the proration was in 2005, when agencies received 95.93 percent of their formula funding.

### **Family Self-Sufficiency Program Would Benefit from Proposed Funding Change**

The existing voucher funding formula creates a disincentive for housing agencies to enroll families in the Family Self-Sufficiency (FSS) program. Normally, when voucher holders experience a gain in income, their required rent contributions increase, and the subsidy provided by their voucher shrinks. That is not the case for voucher holders who are in FSS, however, because the additional rent contributions these families would normally be required to make as their income increases are deposited in escrowed savings accounts. In effect, FSS increases agencies' voucher costs.

The funding formula in place before 2004 compensated agencies for these increased costs, but the new funding formula, which provides additional funds only to compensate for changes in market rent and utility costs, does not. As a result, agencies have been forced to choose between assisting more families with vouchers and enrolling more families in FSS. The number of families participating in FSS dropped by 2,000 in the year after HUD first implemented its new funding policy.\*

Recognizing the problem, the Administration's new budget proposes to adjust the allocation of renewal funds to agencies to reflect the costs of deposits in FSS escrow accounts. While the proposal applies only to 2007, it could continue in future years if Congress continues the same funding policy. The annual cost of the adjustment is likely to be relatively small, about \$15 million based on 2005 data. On balance, this is a very worthwhile change.

\*See Lubell and Cramer, note 5 above.

keep voucher subsidies below what is needed to respond to these market factors, landlords will not accept vouchers and families' rent burdens will increase.

#### *Funding Formula Would Shift About 20,000 Vouchers to Different Agencies in 2007, Causing Instability*

As a result of the deeper funding shortfall in 2007 and the funding formula's failure to reflect actual cost changes, many agencies would have to serve fewer households in 2007 than in 2006. Nearly 70 percent of agencies (or close to 1,700 agencies) will be in this situation, assuming that agencies' voucher costs grow at the HUD formula rate in 2006 and then at the average rate that we have assumed in 2007 based on the Congressional Budget Office projection. We estimate that overall, these agencies would have to cut about 20,000 vouchers in 2007 that families may be using in 2006.<sup>11</sup>

At the same time, about a quarter of agencies would be able to increase modestly the number of families they serve. About 570 agencies would be able to use approximately 20,000 vouchers more than in 2006. Funding for these agencies also will be prorated more deeply than in 2006. Nonetheless, they will be able to use more vouchers than in 2006 due to the proposed lifting of the restriction on using funds only for the number of vouchers an agency is authorized to administer. (In 2006 these agencies will receive a substantial amount of funds they will be unable to use. See discussion at page 20 below.)

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<sup>11</sup> This estimate assumes that agencies will not use carry-over funds in 2006 to lease additional vouchers up to their authorized level. Some 940 agencies could use carry-over funds to serve an additional 16,000 families in 2006, within their authorized leasing limit. Agencies have no incentive to do this, however, since they receive no additional administrative fees for the additional work involved, and under the proposed budget they would not be able to maintain assistance to these families in 2007. See discussion of 2006 funding below.

Certainly, it is better to use housing voucher funds to help needy families than to have the funds sit unused. But it is important to recognize that this shift of 20,000 vouchers to different agencies does *not* reflect a determination that the communities that would be able to serve additional families need the vouchers more than the communities that would face cuts. In fact, the opposite is the case. The areas that would be able to serve more families are those where voucher costs have *fallen* relative to other areas, because rents have declined or voucher holders' incomes have increased.<sup>12</sup> Similarly, the areas that would lose vouchers are those where real housing needs have increased due to rising rent and utility costs or falling tenant incomes.

The shift of 20,000 vouchers from some areas to others is the result of the arbitrariness of the funding formula and its failure to take account of actual voucher cost changes since 2004. Moreover, available data indicate that 60 percent of the agencies that would be able to lease more than their authorized number of vouchers in 2007 used less than 98 percent of their vouchers in 2005, making it uncertain whether they would take advantage of the proposed new flexibility to serve additional families.

In addition, Congress could decide not to approve the Administration's request to lift the prohibition on overleasing. Beginning in 2003, Congress imposed this limitation — overriding a HUD policy that permitted agencies to lease additional vouchers if they can do so within their allocated funds<sup>13</sup> — in its annual appropriations acts as a tool to limit Section 8 expenditures. If Congress were to adopt the Administration's funding level and allocation formula but *not* allow agencies to overlease, about 20,000 fewer vouchers would be funded than in 2006.

By forcing cuts at many agencies while allowing increases at others, the Administration's proposal would fail to provide the stability that local voucher programs badly need after the repeated funding changes of the past three years. Full funding of the renewal formula proposed in the budget would cost approximately \$15.4 billion in 2007, \$1 billion more than the Administration has requested. It is this shortfall that will require the 6.7 proration in formula funding that we have estimated would occur under the budget.

But the Administration's proposed voucher funding level would be sufficient to provide all agencies with enough funding to renew the vouchers they will have leased in 2006 — without any pro rata cut — *if* the funding formula were changed. Rather than continuing to rely on the out-of-date factors in the formula, Congress could direct HUD to allocate funds based on recent data on voucher costs, with awards limited to the level needed to support an agency's authorized number of vouchers. In this way, the distribution method would take advantage of the below-inflation level of cost changes at most agencies in the last several years, and agencies would receive sufficient funds to maintain their vouchers in use.

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<sup>12</sup> It is possible that some of the agencies that would be allowed to lease additional vouchers would instead use the funds to reverse policy decisions they recently have instituted for budgetary reasons, such as increases in minimum rents or prohibitions on rent increases by landlords, and would thereby allow the average cost of a voucher to rise by more than HUD's inflation adjustment. Nearly all of these agencies had unused funds in 2005, however, which suggests that economic forces rather than budget-balancing policy choices caused costs to decline.

<sup>13</sup> This policy was known as "maximized leasing." HUD included formal approval of the policy in a notice issued as part of the section 8 renewal policy authorized by Section 8(dd) of the U.S. Housing Act. See 65 Fed. Reg. 21088, 21090 (April 19, 2000); HUD Notice PIH 2002-6, ¶4(B)(2) (March 3, 2002).

## Adjustment Fund Needed to Restore Housing Choice and Meet Hurricane-Related Needs

The budget proposes that \$100 million of the funds requested to renew housing vouchers be set aside to be used for “unforeseen exigencies as determined by the Secretary” and “for the one-time funding of housing assistance payments resulting from the portability provisions” of the program. (Portability enables a family with a voucher to move to an area where the program is administered by a different agency without losing its voucher.) This proposal could address the current funding formula’s lack of a mechanism to adjust funding to meet portability-related costs, a problem that has undermined a core feature of the voucher program — namely, that families should have a choice about where to live. The set-aside proposal also could help meet some of the unique costs resulting from the 2005 Gulf Coast hurricanes.

### *Portability Funding Essential to Giving Families a Choice of Where to Live*

Portability has been a central feature of the voucher program for nearly 20 years. Congress added the portability requirement to the voucher program in 1987, under President Reagan. Without portability rights, families could not move outside the area served by the agency that issued their vouchers, leaving them unable to move nearer to family members or to places with better job opportunities or schools and less poverty and crime. The geographic areas that local agencies serve can be quite limited: more than 2,400 agencies administer the program, with central cities and rural areas often separated from suburban communities. As a result, without portability, housing vouchers’ vital role in overcoming segregated residential patterns and enabling families to boost their employment prospects by moving to areas with better job opportunities would be severely weakened.

The “budget-based” funding policies that began in 2004 have unintentionally undermined this key attribute of the program by giving agencies strong incentives not to allow portability. When voucher holders move to an area where the program is administered by a different agency, the initial agency must continue paying for the voucher unless the agency in the new destination opts to “absorb” the voucher into its program. If voucher holders move to a locality where rental costs are somewhat higher, the initial agency would face higher costs. And under the new funding formula, which bases agencies’ funding on their costs in a prior three-month period, the agency receives *no* additional funds to cover these new costs, with the result that it may have to serve fewer families.

The current funding formula also gives agencies strong incentives not to absorb vouchers from other areas. Since the agency would receive no additional funds to cover the cost of these vouchers, absorbing a voucher of a family moving into the area generally would mean not serving a family on the agency’s own waiting list. As a result of these altered incentives, many agencies around the country have imposed restrictions on where families may move, despite the fact that such policies may violate the U.S. Housing Act and civil rights laws.

To remedy these problems and protect this important statutory right, a wide range of organizations and analysts have recommended that any budget-based funding policy include a central fund to pay additional portability-related costs incurred by local agencies.<sup>14</sup>

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<sup>14</sup> The most fully-developed proposal is described in Mary K. Cunningham and Philip Tegeler, “Portability and Housing Choice: Preserving the Right to Inter-Jurisdictional Portability Using a Central Reserve Fund,” *Keeping the Promise: Preserving and Enhancing Housing Mobility in the Section 8 Housing Choice Voucher Program, Conference Report of the Third National*

In the 2006 appropriations process, Congress recognized the conflict between the formula funding policy and portability requirements but was unable to fashion an effective solution. The final 2006 bill allowed money from the \$45 million adjustment fund (later reduced by a 1-percent, across-the-board reduction) to be used to help cover portability-related costs, but HUD has indicated it will use those funds first to help agencies that leased more vouchers in the 2004 fiscal year than in the three-month snapshot period used to determine funding levels; only if funds remain will HUD help agencies facing significantly higher costs due to portability.<sup>15</sup> As noted above (see footnote 9), HUD is unlikely to have sufficient funds to make portability-related funding adjustments in 2006.

Perhaps recognizing that the proposed solution was ineffective, the House Appropriations Committee noted that “the issue of portability continues to be troubling” and directed HUD “prior to the submission of the 2007 budget, to develop and submit proposals to minimize the cost that portability could have on PHAs [public housing agencies] operating on a fixed annual budget.”<sup>16</sup>

Under the Administration’s budget, an unspecified amount of the \$100 million set aside from the voucher renewal funds could be used for portability-related costs. However, the budget refers to such a use of these funds as “one-time funding,” which raises the troubling possibility that agencies would receive no help paying portability-related costs beyond the first year, potentially jeopardizing housing assistance for families using vouchers under portability procedures.

Rather than a one-time shift in voucher funding, the creation of a fund for portability-related cost adjustments would be worthwhile and could undo the chilling effect on portability rights created by recent funding policies. Providing funding to destination communities in 2007 and on an ongoing basis also may make sense to assist Gulf Coast evacuees, for the reasons discussed below.

In 2005, some 44,000 families with vouchers moved under portability billing arrangements, according to recent HUD data. Using these data, analysts estimate that portability costs agencies approximately \$39 million on an annual basis.<sup>17</sup> A substantial portion of this cost likely was incurred during the snapshot period used to determine agency funding levels and thus is built into the funding formula. (Some of the same families assisted under portability procedures in May – July 2004 will be receiving similar assistance in 2007.) Only the additional costs need to be met through an adjustment fund, and HUD should have the data needed to estimate those additional costs. If Congress retains a funding policy based on the May – July 2004 period (or some other past period), it is important to include funds to enable agencies to comply with portability requirements and preserve the central goal of choice.

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*Conference on Housing Mobility* (Poverty & Race Research Action Council, December 2005), p. 57, <http://www.prrac.org/pdf/KeepingPromise.pdf>. The concept of a central reserve fund for portability costs was recommended by a broad range of groups endorsing the Final Statement of the National Housing Voucher Summit, page 4 (August 2005), <http://www.nlihc.org/news/summit/finalstatement.pdf>. It has also been recommended by the National Council of State Housing Agencies, the National Association of Housing and Redevelopment Officials, and the National Leased Housing Association.

<sup>15</sup> See HUD Notice PIH 2006-5, ¶5 (January 13, 2006).

<sup>16</sup> See Departments of Transportation, Treasury, and Housing and Urban Development Appropriations Bill, 2006, H.Rpt. 109-153, June 24, 2005, p. 84.

<sup>17</sup> See note 14.

### *Funds Will Be Needed to Address Hurricane-Related Costs*

The Gulf hurricanes of 2005 forced hundreds of thousands of families to flee the Gulf Coast. Housing agencies in many parts of the country are now administering housing vouchers for thousands of these families. HUD has informed Congress that it expects the number of previously HUD-assisted displaced families to increase to more than 40,000 over the course of 2006.<sup>18</sup> In addition, rental costs have increased both in areas where much of the housing stock was devastated and in areas where vacancy rates fell sharply because of the influx of large numbers of evacuees.<sup>19</sup> These events have important implications for voucher program funding needs in 2007.

In communities where evacuees are receiving housing vouchers funded by special disaster funds, housing agencies will face a sudden drop in funding for the last quarter of calendar-year 2007 because Congress has specified that these funds cannot be used after September 30, 2007. If this end date remains unchanged,<sup>20</sup> agencies will lose funds to support a portion of their vouchers for the last quarter of the year covered by the 2007 appropriation. (Although the federal fiscal year ends on September 30, HUD uses each year's appropriations on a calendar-year basis to avoid problems that otherwise would occur when Congress is late in approving appropriations acts.) It also is possible that funds will run out before September 30, 2007, particularly if Congress fails to include the additional \$202 million HUD has requested for disaster vouchers in the pending supplemental appropriations bill.<sup>21</sup> This problem has three different components.

- Families that already were receiving voucher assistance in the Gulf area when the storms occurred face no time limit on assistance. Once the special disaster funding ends, the original Gulf Coast agency that provided their voucher assistance before the storms would again be responsible for picking up the payments. That, however, may prevent those agencies from assisting families that have remained in the Gulf or returned there and now badly need help meeting rising housing costs.<sup>22</sup>

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<sup>18</sup> The Administration's supplemental appropriations request submitted to Congress February 16, 2006 indicates that HUD anticipates providing special disaster voucher assistance to some 44,000 displaced families that had received some form of HUD-assisted housing or were homeless prior to Hurricanes Katrina or Rita.

<sup>19</sup> HUD recently concluded that rental costs have increased 25-30 percent in New Orleans and 15-20 percent in Baton Rouge since Hurricanes Katrina and Rita, and is conducting surveys to determine the extent of the rent increases in other communities housing significant numbers of Katrina evacuees. 71 Fed. Reg. 11286 (March 6, 2006).

<sup>20</sup> In the recent supplemental request, the Administration seeks an additional \$202 million for disaster Section 8 vouchers, but proposes to retain the September 30, 2007 end date for use of the funds. HUD's policy materials on the Disaster Voucher Program indicate that HUD may intend to apply a time limit *to the families*, rather than to the *funding source*. Such a policy appears to be contrary to the provision of the December 2005 supplemental appropriations act that provided the Section 8 funds, as Congress did not include language requested by the Administration that would have imposed an 18-month time limit on families' receipt of assistance. Instead, Congress imposed an end date for use of the funds that was 21 months in the future. While this was a positive step, it was not an entire solution. Congress needs to fix the problems that likely will ensue from the interaction between the end date for use of the supplemental funds and other voucher program requirements and funding.

<sup>21</sup> On March 8, 2006 the House Appropriations Committee approved a version of the supplemental spending bill that does not include any additional Section 8 voucher funds.

<sup>22</sup> HUD policy obligates local agencies in the disaster area to certify that they will manage their voucher programs in a way that guarantees they will have funds available to support displaced voucher families when special funding ends. Agencies that do not make this certification are threatened with a reduction in funding. Consequently, agencies are

Therefore, Gulf Coast agencies should be assured that other funds will be provided to cover evacuees' voucher costs for the last quarter of calendar year 2007. Congressional direction to HUD to use a portion of the \$100 million adjustment fund to meet these costs could be helpful for this purpose. It also may make sense for Congress to make a permanent allocation of additional vouchers to the agencies where families have relocated, so that Gulf Coast agencies retain their full complement of vouchers to meet the serious housing needs they now face. The cost of such an allocation likely would be between \$10 and 20 million for the last quarter of 2007.

- Approximately 20,000 housing units in the most heavily damaged counties and parishes were receiving HUD-funded project-based subsidies when the hurricanes hit. Roughly half of the families that lived in these units likely now are eligible for special disaster vouchers, because the apartments in which they lived suffered substantial damage. Some of these families will be able to return to their previous homes before September 30, 2007. Others may be informed prior to that date that their homes will not be rebuilt, in which case they should be eligible for a new tenant protection voucher. (As explained below, however, the Administration's proposal to limit the number of tenant protection vouchers may adversely impact these families.)

Many other families will have neither of these clear alternatives. Approximately \$5-\$10 million in additional funds are needed to continue providing them with housing voucher assistance during the last quarter of 2007 until their former homes are rebuilt or final decisions on rebuilding are made. Additional funds likely will be needed to continue to provide assistance to individuals and families that were homeless prior to the hurricanes and were issued disaster vouchers. The proposed \$100 million adjustment fund would provide a flexible source of such funding. (Funding may continue to be needed in 2008 for this purpose.)

- In some cases, housing agencies in other parts of the country provided their own housing vouchers to displaced families that previously had received other forms of HUD housing assistance, such as public housing or housing for the elderly or people with disabilities. Recognizing the hardship that this humanitarian reaction would cause to other applicants on agencies' waiting lists, HUD has provided supplemental funding to these agencies to offset their costs, in effect freeing up agencies' regular voucher funds to assist families on their waiting lists. When the special disaster voucher funds end in 2007, however, these agencies will lose one of their funding streams, and they may not have sufficient funds to cover the full number of families receiving voucher assistance. To avoid precipitous termination actions, these agencies may need a portion of the adjustment funds. (HUD has not made public the information needed to estimate the potential cost of assuring that families in this group continue to receive voucher assistance through all of 2007 if needed.)

Finally, agencies in the Gulf Coast — and possibly in some additional areas where many evacuees relocated — face substantially increased per-voucher costs because rents have escalated as a result of housing shortages. These cost increases will not be reflected in agencies' 2007 funding levels if HUD follows past practice, as the funding levels are based on cost changes several years earlier. To meet these increased costs, agencies will be forced to assist fewer families at a time when they need to be serving as many families as possible as part of a successful

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under strong pressure not to serve all of the families they otherwise could. See *Disaster Voucher Program (DVP) Operating Requirements*, Notice PIH 2006-12, ¶ 4(p), p. 19 (February 3, 2006).

rebuilding effort. Other agencies also may face “unforeseen exigencies” deserving of funding adjustments, but the serious needs of the Gulf Coast agencies are foreseeable now. Congress should direct HUD to use a portion of the \$100 million adjustment fund to meet increased housing costs due to the 2005 Gulf hurricanes.

In short, currently available information indicates that most and possibly all of the requested \$100 million adjustment fund is needed just to meet the portability- and hurricane-related costs that can be anticipated now. Funds that may prove not to be needed for these two clear purposes could be used to give HUD some flexibility to ameliorate manifest hardships (such as shortfalls at agencies in communities where market rents rise sharply) that would result from a rigid funding policy. In addition, as explained in note 9, adjustment funds for 2006 appear likely to fall more than \$55 million short of the amount required to meet the specific needs for which Congress provided those funds; any excess 2007 adjustment funds could potentially be used to make up for this shortfall.<sup>23</sup>

### **Change in Tenant Protection Vouchers Will Harm Some Communities Losing “Hard” Units**

The budget requests \$149 million for tenant protection vouchers to replace federal housing assistance that has been eliminated. (Each year, thousands of public housing units are demolished and private owners of 20,000 – 30,000 apartments with “project-based” subsidies cease to participate in HUD programs.<sup>24</sup>) This \$149 million request is nearly \$30 million below the \$178 million appropriated for this purpose in 2006. The funding requested would support about 21,800 replacement vouchers, about 5,000 fewer than were funded in 2006 or awarded in 2005. The budget requests authority to use other unobligated funds to supplement the appropriation, apparently anticipating that additional replacement vouchers will be needed. It will be important for Congress to assure that the needed funds will be available.

In a major policy shift, the budget would limit the award of tenant protection vouchers to the replacement of subsidized units that were under lease at the time they were demolished or disposed of. In the past, tenant protection vouchers were generally provided to replace *all* subsidized units. This is because the vouchers were intended not just to help specific residents whose units had been eliminated, but also to compensate the community for the loss of affordable housing resources.<sup>25</sup> As

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<sup>23</sup> Adjustment funds also are needed to remedy HUD’s failure in 2006 to implement the Congressional directive to provide additional funding to agencies that did not use a portion of their authorized vouchers during the “snapshot” period because the vouchers were reserved to meet commitments to “project-base” the vouchers in developments under construction. An amendment requiring this change was incorporated in the Senate bill and retained in conference. Due to a technical problem with the wording of the provision in the final bill, HUD has refused to implement its clear intent, leaving many agencies with continuing funding shortfalls. See PIH Notice 2006-5, ¶3(D).

<sup>24</sup> In 2005, HUD awarded 26,540 new tenant protection vouchers. See 70 Federal Register 71,548 (November 29, 2005). HUD awarded 29,296 new tenant protection vouchers in 2004. See 71 Federal Register 17479 (April 6, 2006). In the eight previous years, HUD awarded about 275,000 additional vouchers to replace other federal housing subsidies. Will Fischer and Barbara Sard, “Sources and Methods Used to Estimate Components of Changes in Section 8 Expenditures From 1996 to 2003,” Center on Budget and Policy Priorities, August 23, 2005, available at <http://www.cbpp.org/3-16-05hous-meth.pdf>.

<sup>25</sup> Provisions of the U.S. Housing Act concerning demolition of public housing authorize use of funds for replacement of lost units and not just for relocation of existing tenants. (See sections 18(h) and 24(d)(1), 42 U.S.C. §§1437p(h) and v(d)(1).) HUD’s policy to award vouchers for the full number of subsidized units lost is contained in Notices PIH 2005-15 (April 26, 2005) and 2004-4 (March 29, 2004) (for public housing) and PIH 2001-41 (for conversion of privately-

a result of the proposed change, communities where some units in a subsidized building are vacant at the time the subsidies are ended would permanently have fewer subsidies available to help low-income people afford housing.

Units may be vacant for a number of reasons, including poor maintenance that has left units in poor condition, decisions by tenants to move out in advance of a planned demolition, and actions by private owners to leave units vacant so they will be available to rent to market-rate tenants after a project-based subsidy contract ends. Without evidence that a community does not need affordable housing resources (such as the absence of a waiting list for vouchers), there is no sound reason for this policy shift, which will permanently reduce the housing assistance available in some communities. The policy shift may well be motivated by the desire to reduce future federal housing spending.

This change — as well as the reduced funding request for tenant protection vouchers — could be particularly harmful for areas of the Gulf Coast that were hit hard by the hurricanes. If a decision is made to demolish or sell assisted-housing developments in these areas because of storm damage, it will likely occur well after the units are no longer technically under lease, even if they were occupied at the time the storm struck. The proposed language thus may call into question whether the pre-hurricane residents of such units are eligible for replacement vouchers.

### **Administration's Budget Will Again Cause Cuts in Some Local Programs**

The new retrospective funding policies in effect since 2004, combined with a funding shortfall in 2005, have resulted in cutbacks in the number of families receiving voucher assistance. (HUD acknowledged in January 2005 that the 2005 appropriation was more than 4 percent short of the level needed to provide agencies with the full amounts due to them under the funding formula.<sup>26</sup>) In 2006 about two-thirds of agencies will be able to reverse some or all of these cutbacks, thanks to an increase in voucher renewal funding for 2006 and a reduction in average voucher costs. One-fourth of agencies, however, will not receive sufficient funds in 2006 even to maintain the number of families that received voucher assistance in 2005. The proposed budget for 2007 will undo a portion of these recent recoveries and cause deeper cuts at agencies harmed by the 2006 appropriation.

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owned units). In the latter notice at pages 9 - 10, HUD states: "When HUD provides vouchers to a PHA as the result of a housing conversion action, HUD will offer housing choice voucher funding on a one-for-one replacement basis to make up for the loss of the affordable housing units in the community, subject to the availability of appropriations." In 2006 HUD may be attempting to alter these longstanding policies without Congressional authorization. PIH Notice 2006-5, concerning voucher funding policy in 2006, includes a sentence stating that funding for tenant protection vouchers and related administrative fees "will only be provided for occupied units in the affected project at the time of the PHA's application for such voucher funding." See ¶6(c), page 4 (concerning fees for tenant protection vouchers).

<sup>26</sup> In a letter sent on January 21, 2005 to state and local housing agencies, HUD announced its determination that the cost of funding the number of vouchers eligible under the Congressional formula exceeded the available appropriation by about four percent. The calculation sheets HUD provided to agencies shows a reduction of 4.083 percent.

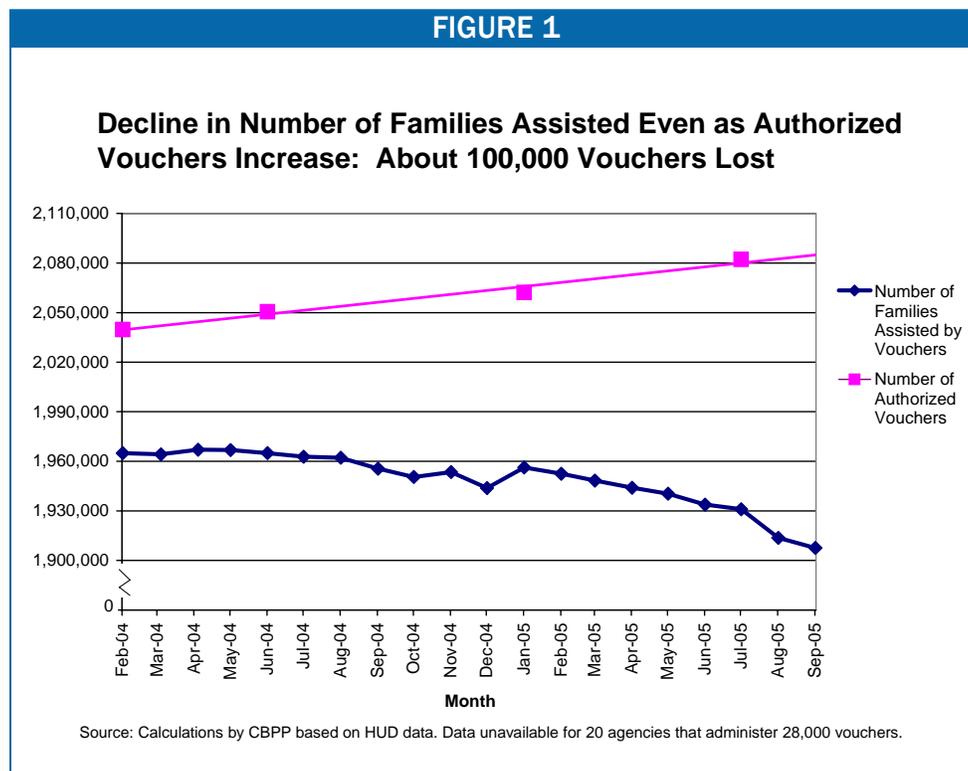
## Funding Shortfalls, Policy Changes Caused Voucher Reductions in 2004 – 2005

HUD data through September 2005 demonstrate the harmful effects of the 2004 and 2005 voucher funding policies.

### *Loss of 100,000 Vouchers*

In April 2004, before HUD announced the new funding policy it imposed that year, available data indicate that about 1,967,000 families received housing assistance under the voucher program. Seventeen months later, in September 2005, only 1,908,00 families were receiving voucher assistance — a loss of 59,000 vouchers — despite the award of more than 50,000 additional tenant-protection vouchers to agencies during this period to assist families that were losing other forms of federal housing assistance.<sup>27</sup> The result was a reduction of more than 100,000 in the number of low-income families receiving assistance.

In some communities, housing agencies terminated voucher assistance to families participating in the program. More commonly, agencies shelved vouchers as families left the program voluntarily, rather than reissuing the vouchers to families on the waiting list.



<sup>27</sup> These figures omit data for 20 agencies that were authorized to administer 28,000 vouchers because they did not report sufficient leasing data to HUD during the relevant period. HUD data show an increase of 58,412 vouchers from January (or in a few cases, February) 2004 through July 2005 for the more than 2,400 agencies included in this calculation.

### *Recent Cost-Cutting Measures Have Undermined Program Effectiveness*

These cuts in the number of families receiving voucher assistance occurred despite agencies' actions to reduce average voucher costs. Voucher costs increased at a considerable rate in the beginning of the decade, primarily because the gap between rental costs and incomes was the largest in 30 years. The rate of increase in voucher costs began to slow in the first part of 2003, however, as the underlying economic causes of cost growth abated.<sup>28</sup> The Congressional Budget Office projected that voucher cost changes would stabilize at about the rate of inflation beginning in 2004.

Instead of waiting for the normal dynamics of a market-based program to take effect, however, HUD precipitously altered the method of allocating voucher renewal funds in April 2004. Faced with funding shortfalls and uncertainty about the future, many agencies adopted policies to reduce average voucher costs, such as cutting the maximum voucher subsidy and increasing rent payments by the poorest families. (Agencies are permitted to charge a minimum rent of \$50 per month regardless of how low a family's income is. Prior to 2004, only a minority of agencies imposed such a charge on the most impoverished voucher tenants. A Center survey in 2004 found that about half the agencies reporting insufficient funds in 2004 had increased minimum rent charges.<sup>29</sup>)

Some agencies also prevented families from using vouchers to move to neighborhoods with higher rental costs, regardless of the better job opportunities such neighborhoods might offer. In addition, many agencies denied rent increases to owners, even if the proposed increases were clearly justified by market changes. Despite these cost-cutting steps, HUD data indicate that nearly half of all state and local housing agencies received insufficient funds in 2005 to provide assistance to the number of families they served in 2004, forcing them to serve fewer families.<sup>30</sup>

As a result of these cost-cutting actions, average voucher costs began declining in *nominal* terms (i.e., even without adjusting for inflation) beginning in November 2004. Overall, from the high point in November 2004 through September 2005, the latest month for which we have data, average voucher costs declined about one percent. According to HUD data, the average cost of a voucher increased by 0.3 percent from calendar year 2004 to 2005, less than one-tenth of the rate anticipated by HUD's inflation factors.

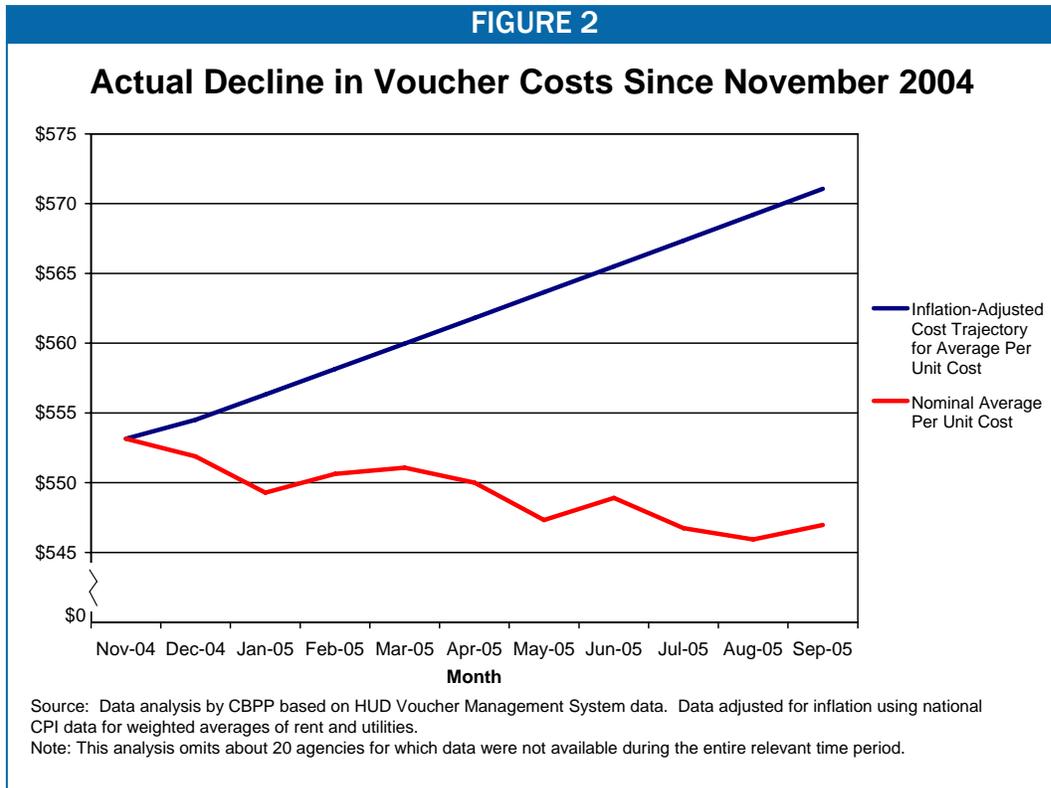
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<sup>28</sup> Will Fischer and Barbara Sard, "HUD Data Show Housing Voucher Costs Leveled Off Starting In 2003 As Rental Market Cooled," Center on Budget and Policy Priorities, revised August 23, 2005, <http://www.cbpp.org/3-16-05housing.pdf>.

<sup>29</sup> Barbara Sard and Will Fischer, "Further Action By HUD Needed to Halt Cuts in Housing Assistance for Low-Income Families," Center on Budget and Policy Priorities, revised July 15, 2004, <http://www.cbpp.org/4-26-04housing.pdf>. A glossary explaining the major policy responses housing agencies made to funding shortfalls beginning in 2004 is available at <http://www.cbpp.org/7-15-04housing-glossary.pdf>.

<sup>30</sup> Using data on actual voucher leasing and costs provided by housing agencies to HUD, CBPP calculated the average number of families served by each agency in calendar 2004, and the number of vouchers that could be supported by the funding HUD provided to the agency for 2005. In 2005, 46 percent of agencies received insufficient funds to support the authorized vouchers they used in 2004. Some agencies were able to avoid cutting vouchers in 2005 by using reserve funds accumulated in previous years. HUD policy limited agency use of reserve funds to the first quarter of 2005. The FY 2005 appropriations act required HUD to reduce agency reserves from one month of subsidy costs to one week by September 30, 2005.

FIGURE 2



Based on available data through September 2005, we estimate that average voucher costs will increase 1.6 percent from 2005 to 2006, half of the average inflation rate of 3.2 percent under HUD's formula.<sup>31</sup>

### Cost Declines and 2006 Funding Increase Permit Some Local Improvements

HUD has notified agencies that their 2006 funding will be 5.4 percent below the level set by the formula. Although this is a deeper proration than the 4.1-percent reduction imposed in 2005, we estimate that about two-thirds of housing agencies will be able to serve more families in 2006 than they did in 2005. This improvement is possible largely because of the cost reductions imposed by many agencies, which have kept their voucher cost increases below the increases anticipated by HUD's inflation factors.

Some agencies also are likely to receive more funding in 2006 than in 2005 because of the additional money they will receive from the \$44.5 million adjustment fund (see pages 6-7). This additional money is intended to compensate agencies that were especially harmed by the use of the three-month snapshot as the basis of the funding formula.

<sup>31</sup> This estimate assumes that costs at state and local agencies will remain flat in the last quarter of 2005 and then increase beginning January 1, 2006 at the rate anticipated by the applicable HUD inflation factor. The estimated rate of increase is half of the average change anticipated by HUD because costs declined in nominal terms during the nine months of 2005 for which we have data, rather than increasing at the 3.4 percent annual average rate of HUD's 2005 inflation factors.

Overall, we estimate that about 1,660 agencies will be able to serve a combined total of about 100,000 more families in 2006 than received voucher assistance in 2005, *if* these agencies use all of their available funds.<sup>32</sup> (About 15 percent of these agencies received an allocation of additional vouchers from HUD during 2005, accounting for roughly 18,000 of the potential increase of 100,000 in the number of families these agencies will be able to serve.) This means that many agencies might offer vouchers to a modest number of families on their waiting lists for the first time in several years.

At the same time, recent policy changes limiting the reserves that agencies are permitted to hold have left 31 percent of agencies with no cushion to meet costs in excess of their annual funding level if local market factors should cause costs to rise.<sup>33</sup> An additional 12 percent of agencies have a cushion of less than two percent of their 2006 funding. These agencies in particular are likely to manage their voucher programs conservatively, erring on the side of underspending.<sup>34</sup> Moreover, agencies no longer have a financial incentive to use as many vouchers as possible, as they earn the same amount of administrative fees regardless of the number of families they serve. These recent changes, as well as the fear of future funding instability, will likely lead agencies to use fewer vouchers in 2006 than the available funds permit.

Despite the improving prospects for most local voucher programs, some communities will suffer further cuts in 2006. We estimate that about 550 agencies, or roughly one-fifth of all agencies, will need to cut about 13,000 vouchers in 2006 that families were using in 2005 (or to adopt cost-cutting policies that will reduce voucher costs by an equivalent amount). About 60 percent of these agencies had already cut vouchers in 2005, compared to the number of families they served in 2004. Thus, the net increase in 2006 in the number of families able to receive voucher assistance using available funds — other than families shifting from another HUD program to the voucher program — is about 70,000.

Typically, the agencies that are likely to have to *cut* vouchers in 2006 are agencies that did a good job at using their voucher funds in 2005 (possibly drawing on reserves to augment the 2005 renewal funding), without excessive growth in their average per-voucher costs. They will be short of funds

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<sup>32</sup> These agencies could serve an additional 16,000 families if they used carry-over funds from 2005. See note 11 above.

<sup>33</sup> As of January 1, 2006 HUD has eliminated program reserve funds accumulated by agencies in 2004 and earlier years. HUD Notice PIH 2006-03 (January 11, 2006). In effect, HUD recaptured the remaining up-to-one-week of reserves left after the reduction mandated by the 2005 appropriations act. See note 29. In the same notice, however, HUD instructed agencies that at least for now they may retain carry-over funds from 2005, and could use these funds “to assist additional families up to the number of units under contract.” ¶9. (The “number of units under contract” is the authorized number of vouchers.) The notice implies that HUD may recapture carry-over funds that are not being utilized, but it provides no further guidance.

<sup>34</sup> It is difficult for agencies to manage their programs to spend exactly 100 percent of their annual funding, as they have limited control over many of the factors that determine how much they spend. For example, agencies can control the number of vouchers they issue but not the number of families that lease up with newly-issued vouchers, and they have virtually no control over such other cost factors as family incomes, the number of families that leave the program, and the level of rents in the community. Recognizing this fact, HUD allowed agencies to maintain at least one month of funding in reserve, and to draw on these funds if reasonably needed. Congress reduced the reserve level to one week effective September 31, 2005. HUD acted on its own to eliminate the previous reserves altogether, although agencies that do not spend all their funds may again be allowed to build a reserve. In one respect the current system is an improvement over the past: agencies have direct access to the carry-over funds and do not have to ask for HUD’s permission to use them.

in 2006 largely because the funding available is not sufficient to meet voucher costs that increased at no more than anticipated by HUD's inflation adjustments since 2004.<sup>35</sup> (As discussed above, HUD is cutting funding due under the formula in 2006 by 5.4 percent.) Agencies likely will be able to make the necessary reductions by shelving vouchers as families leave the program voluntarily, rather than terminating voucher assistance to current families. That means, however, that a larger number of housing-needy families and individuals in these communities will not be able to receive housing assistance, causing longer stays in homeless shelters and other adverse consequences.

### **Continuation of Formula-Based Funding Wastes More Than \$200 Million in 2006**

The fact that one-fifth of housing agencies will have to reduce the number of families receiving assistance in 2006 is the result *not* of inadequate appropriations but of the inefficient funding formula. We estimate that 740 agencies will receive more than \$200 million in *excess* voucher renewal funding in 2006.<sup>36</sup> For these agencies, actual voucher costs have lagged behind HUD's inflation factors since the snapshot period in mid-2004. Unless their costs in 2006 grow faster than the applicable inflation adjustment, these agencies will have more funds than they need to support all of their authorized vouchers. As noted, agencies are prohibited from leasing more than their authorized number of vouchers, so this \$200 million in "excess" funds will not be used to assist households that need help. (At this point, it is not clear whether agencies will be allowed to retain these funds as a reserve for future years or whether HUD will recapture the funds.<sup>37</sup>)

If the funds appropriated for 2006 were distributed efficiently among agencies — in other words, if the voucher funding formula took account of recent leasing patterns and rental costs instead of relying on out-of-date data — no vouchers would have to be cut in 2006.

### **Voucher Funding At Risk Without Increase in Overall HUD Funding Allocation**

Affordable housing and community development programs are a low priority in the Bush Administration's budget request for 2007. Under the request, funding for HUD programs would be cut by \$622 million in 2007, compared to the 2006 appropriation, a reduction of 3.9 percent in real terms. In comparison, total funding for discretionary (or annually appropriated) programs outside

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<sup>35</sup> Of the 547 agencies we estimate will face cuts in 2006, detailed cost data are available for 526. For 72 percent of these agencies, average voucher costs increased at no more than HUD's inflation factor from the "snapshot" period of May – July 2004 through September 2005, the last month for which we have data.

<sup>36</sup> The extent of overfunding in 2006 is more than twice what we had estimated in our August 2005 analysis of the House bill, despite the lower final voucher renewal funding figure. See "High Stakes for the Housing Voucher Program in the 2006 Appropriations Bill," August 24, 2005, <http://www.cbpp.org/8-24-05hous.htm>. The primary reason for the difference is that our earlier analysis was based on HUD data through January 2005. After January, we assumed that agencies' per-voucher costs would increase at the rate of the HUD inflation adjustment. The actual cost data through September 2005 that is now available to us shows that that assumption was markedly incorrect. In fact, after a small increase in February and March, 2005, voucher costs resumed the path of month-over-month declines that began in November 2004. See figure 2 on page 18. The estimate of "wasted" funds does not include agencies with special funding agreements under the Moving to Work demonstration that allow them to use voucher funds for public housing and other purposes.

<sup>37</sup> See note 33.

of defense and homeland security would be cut by 2.6 percent. HUD programs therefore would fare somewhat worse than other non-defense discretionary programs as a whole.

The budget request recommends major cutbacks in public housing, community development, and new housing for low-income people who are elderly or have disabilities. Funding for states and localities under the Community Development Block Grant would be cut by \$736 million in 2007, ignoring losses due to inflation, or 21.9 percent in inflation-adjusted terms.<sup>38</sup> This cut would follow a substantial reduction in 2006, when Congress agreed to reduce CDBG formula grant funding by \$406 million in comparison to 2005. If Congress accepts the Administration's proposal for 2007, CDBG funding would fall by a total of \$1.1 billion from 2005 to 2007, a reduction of 31 percent in real terms.

The 2007 budget request also continues a multi-year assault on public housing. After adjusting for inflation, total funding for public housing would decline by 9.6 percent in 2007.<sup>39</sup> Funding for public housing in 2007 would be \$1.26 billion below 2002 funding levels, adjusted for inflation, a real reduction of 28 percent.

The Bush Administration proposes to slash funding for special needs housing, as well. Funding for Section 202 housing for the low-income elderly and Section 811 housing for low-income people with disabilities would be cut by \$307 million in 2007, a reduction of 33.7 percent (adjusted for inflation). While the proposed funding levels would be sufficient to maintain current commitments for tenant-based and project-based rental assistance under these programs, these levels would sharply reduce funding for new construction of supportive housing units for low-income people who are elderly or have disabilities. According to HUD estimates, the budget request would support the construction of only 2,700 new units of supportive housing for the elderly, about half the number of new units funded in 2005.

The requested substantial reductions in funding for key affordable housing and community development programs come on the heels of a new report by HUD that shows continuing strong needs for housing assistance across the country. This report indicates, for example, that more than 5 million low-income families have "worst-case" housing needs — which means they pay over half of their income for housing or live in severely substandard housing — including 1.1 million low-income elderly households and 510,000 low-income households containing people with disabilities. The need for senior housing is certain to grow as the number of senior Americans is expected to double over coming decades.

Moreover, these reduced funding levels are being proposed at a time when the Gulf Coast region is struggling to rebuild or replace hundreds of thousands of units of housing that were damaged or destroyed by Hurricanes Katrina and Rita. These losses include substantial losses to the public housing and project-based stock in southern Louisiana and Mississippi. While HUD Secretary Alphonso Jackson has assured Congress that HUD intends to restore federally-subsidized housing

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<sup>38</sup> The reduction in CDBG formula grant funding in 2007 may be greater than \$736 million because the Administration has proposed to set aside \$200 million to be allocated as "bonus grants." If Congress agrees with this proposal, a total of \$936 million would be cut from formula grants, in comparison to 2006.

<sup>39</sup> This includes the funding levels proposed for the Public Housing Operating Fund, Public Housing Capital Fund, and the HOPE VI Revitalization of Severely Distressed Public Housing Program.

on the Gulf Coast, the Administration has to date presented no plans and requested no funds to do so.

The impact of the cuts proposed in particular HUD programs such as CDBG and housing for people who are elderly or have disabilities is not likely to be limited to those programs themselves. The proposed cuts are likely also to have a negative impact on the final funding levels that Congress will provide for many other HUD programs as well, very possibly including programs such as Section 8 and homeless assistance that would receive increased funding under the President's budget.

This impact was evident in the 2006 budget cycle. For 2006, the Bush Administration had proposed deep cuts in funding for CDBG and Section 811 housing for people with disabilities. Because these programs enjoy strong bipartisan support in Congress, however, Congress ultimately funded CDBG and Section 811 at levels well above the President's 2006 request. Yet Congress came up with the money for these funding restorations in part by reducing funding for Section 8 and homeless assistance to levels below those the President had requested.<sup>40</sup>

Another strategy Congress has increasingly used in recent years to boost funding for favored programs above the levels requested by the President is to help offset the funding boosts with an across-the-board cut in discretionary programs generally. In 2006, Congress included in the supplemental appropriations bill it approved in December an across-the-board cut of one percent that applied to nearly every discretionary program.

This dynamic is likely to be repeated during the fiscal year 2007 budget cycle. Unless Congress begins the budget process by approving a budget resolution that sets the overall discretionary funding target for 2007 at a level significantly above that which the Administration has proposed, Congress will again find it difficult to restore funding for CDBG and other popular programs without cutting back on funding on other important HUD programs, such as the Housing Choice Voucher Program.

## **Conclusion**

When the Congressionally-mandated Millennial Housing Commission conducted a review of federal housing policy in 2001, it concluded that the voucher program was "flexible, cost-effective, and successful in its mission" and recommended that it continue to serve as the "linchpin" of federal housing policy. Yet the voucher program's effectiveness depends on adequate, reliable funding. If landlords do not believe that the federal government will continue to fund existing housing vouchers, they are likely to be less willing to rent apartments to voucher holders. Unreliable funding also disrupts the lives of low-income households — primarily working families, senior citizens, and people with disabilities — who rely on vouchers to help them pay their rent each month, and makes it difficult for state and local housing agencies to plan and manage their voucher programs effectively. The consequences of funding instability have become most evident over the

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<sup>40</sup> The funding restored by Congress to CDBG and Section 811 substantially exceeded the amount trimmed from Section 8 and other programs. Still, the point holds that when large cuts are proposed in popular programs, it becomes more difficult to sustain proposed nominal funding increases in other programs.

course of the past two years in the dramatic decline in the number of families receiving voucher assistance.

Thanks to recent reductions in average voucher costs and a modest increase in voucher renewal funding for 2006, a majority of housing agencies will have the opportunity to reverse this decline in the current year. As a result of the flawed funding distribution formula, however, a large minority of agencies will still face shortfalls in 2006, and this number will increase to a majority of agencies in 2007 under the President's budget, according to our estimates. This instability will continue so long as voucher funding is distributed through a formula that does not make accurate adjustments for local changes in voucher costs.

Congress can restore fiscal stability to state and local housing agencies and permanently reverse the recent decline in the number of families using vouchers. To do so, it must act to improve the voucher renewal formula in the 2007 appropriations bill, as well as agree to provide at least the funding level the President has requested for the voucher program.