Center on Budget and Policy Priorities

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To: Interested Parties
From: Barbara Sard, Douglas Rice and Will Fischer
Re: **Initial Assessment President's 2007 Budget: Impacts on Housing Voucher Program and Hurricane Recovery**
Date: *Revised* February 17, 2006

On February 6, the President released a budget request for fiscal year 2007 that proposes to cut $622 million (1.8 percent) from the HUD budget, in comparison to FY 2006 funding levels, not counting losses due to inflation. The request recommends major cutbacks in community development, special needs housing, and public housing programs. CDBG formula grants would be cut by $736 million (19.8 percent); taken together, housing programs for the elderly and for people with disabilities would be reduced by $307 million (31.6 percent); and public housing funding would fall by $459 million (7.5 percent). Homeless assistance and HOME formula grants would receive funding increases of 15.8 and 7.3 percent, respectively. As explained below, the Administration proposes a funding increase for the Housing Choice Voucher Program that would be sufficient to fund about the same number of vouchers in 2007 that were funded in 2006.

2007 Housing Voucher Proposal

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. We estimate that the $14.3 billion requested for renewal of existing housing vouchers under the bill's funding formula would provide housing assistance for approximately 2,075,000 families in 2007, the same number of families that can be assisted in 2006. This is about 96 percent of the 2.165 million vouchers authorized in 2007. (The request includes an additional $100 million for voucher costs not covered by the funding formula, discussed further below. The funds requested for tenant-based rental assistance also support program administration and additional vouchers to replace other federal housing assistance that has been eliminated.)

The Administration's proposal would not, however, provide the stability that local voucher programs badly need after the repeated funding changes of the past three years. At the funding level requested, we estimate that the pro rata cut applied to each agency's eligibility for funding under the proposed formula would be 25 percent greater in 2007 than the 5.25 percent cut HUD has indicated it is likely to impose in 2006. The result will be that many agencies will have to cut their voucher programs compared with the level of assistance they will be able to provide in 2006, while other agencies may be able to increase modestly the number of families they serve. (Some agencies will be able to serve more families than in 2006 despite the deeper pro rata reduction because of other changes in the Administration's proposed funding policy discussed further below.)

From early 2004 through September 2005 (the latest data available to us), the number of families receiving voucher assistance fell by nearly 65,000. Closer to 100,000 families actually lost voucher assistance in this period, however, because an additional 40,000 families were transferred into the voucher program as a result of the demolition of public housing and other losses of federal housing assistance. This sharp reduction in the number of families assisted has been caused by changes in voucher funding policy, funding shortfalls, and the substantial uncertainty that these factors have generated among public housing agencies, which has led some to administer their programs very conservatively.

We estimate that the level of voucher renewal funding proposed in the FY 2007 budget, like the amount allocated in FY 2006, would be sufficient to restore funding for a large portion of the number of vouchers lost in 2004 and 2005. It is important to note, however, that the local impact of the funding restoration would not be uniform. While most agencies will be able to serve more families in 2006 than they did in 2005, about a quarter will have to reduce voucher assistance in their communities, cutting about 13,000 vouchers. More agencies will face shortfalls in 2007. About two-thirds of public housing agencies would receive funding for fewer vouchers in 2007 than in 2006, reversing somewhat any increase in families assisted they may achieve in 2006. We estimate that these agencies would lose funding for about 20,000 vouchers in 2007, while other agencies will be able to use about the same number of additional vouchers. The cause of these losses and funding shifts is the dollar-based funding formula that has been in effect in 2005 and 2006, and which the Administration has proposed to apply again (albeit in a slightly modified form) in 2007.

Under the dollar-based funding formula, the amount of voucher funding received by each agency is based on the agency's voucher costs during a three-month period in mid-2004, adjusted by inflation factors set by HUD. Because the data that determine both the basis and the inflation adjustment are out of date (HUD's inflation factors are derived from two-year-old rent and utility data), each agency's funding allocation fails to reflect recent changes in local voucher costs, and there is no mechanism to shift resources to, or away from, agencies that have experienced substantial recent cost changes. As a result, while some agencies receive funding that is insufficient to maintain assistance to families they have assisted in the previous year, other agencies receive more funding than they can use to lease up to their authorized number of vouchers because of the formula's inefficiency. (We expect to issue estimates of local effects by early March.)

While the FY 2007 budget request proposes some slight modifications of the 2006 funding formula, these changes would not remedy the misallocation of resources caused by the dollar-based formula. Most importantly, the Administration proposes to eliminate the restriction that public housing agencies may not use funding to lease more vouchers than they are currently authorized to lease. (The proposed bill language would delete the prohibition on "overleasing" that Congress has imposed for the last four years.) In effect, this proposal would remove each agency's leasing cap based on its number of authorized vouchers. This change would resolve one consequence of the misallocation of resources that results from the current funding policy, namely, that funding is wasted when some agencies receive more than they can use to lease up their authorized number of vouchers. (By our estimate, $186 million will be wasted in this way in 2006.) However, this modification would do nothing to help agencies that are shortchanged by the dollar-based funding formula.

Under the voucher funding levels proposed in the FY 2007 budget request, it is possible to provide all agencies with funding sufficient to renew the vouchers they will have leased in 2006, *if the funding formula is changed*. The solution is to change the funding policy to allocate funds based on recent data on voucher leasing and costs, rather than to continue to rely on the out-of-date formula proposed by the Administration.

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 to make a one-time funding adjustment for costs related to families moving to more expensive areas where the voucher program is administered by a different agency (known as "portability" costs). For example, rental costs in areas with more jobs are likely to be higher than in rural or some urban areas. This proposal could address significant drawbacks of the current formula funding policy. In particular, the absence of a mechanism to adjust funding to meet portability-related costs has undermined a core feature of the voucher program – namely, that families should have a choice about where to live. The potential benefit of this set-aside proposal for areas affected by the 2005 Gulf Coast hurricanes is discussed below.

The Administration's proposal also recognizes that the formula funding policy has created a disincentive for state and local housing agencies to enroll families in the Family Self-Sufficiency (FSS) program, HUD's primary program to promote work and increase earnings among voucher recipients. Under FSS, families' share of the rent in effect is frozen at their pre-enrollment level, with the additional contributions they would be required to make toward rent due to increased income shifted into escrowed savings accounts. In effect, FSS increases subsidy costs for agencies. The Administration proposes to adjust the allocation of renewal funds to agencies in 2007 to reflect such increased costs. This is an important change.

Finally, a note on voucher cost trends. According to HUD data, from 2004 to 2005 the average cost of a voucher increased by less than 0.4 percent, about one-tenth of the rate anticipated by HUD's inflation factors. Based on available data through September 2005, we estimate that the average voucher cost will increase less than 1.5 percent from 2005 to 2006, compared with an average inflation rate of 3.2 percent under HUD's formula.

Administrative Fees

For 2007, 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, however, would be distributed to all agencies through the administrative fee formula. As a result, most agencies would receive a fee increase of only 1.9 percent. The remainder of the requested increase in funding for administrative costs would be allocated by HUD to agencies that receive additional tenant protection vouchers. (These new vouchers are discussed below.)

For coordinators for the Family Self-Sufficiency program, the budget requests $47.5 million, a small ($20,000) decrease from the funding level in 2006.

Tenant Protection Vouchers

The budget requests $149 million for tenant protection vouchers replacing other forms of federally assisted housing, a reduction of nearly $30 million from 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.

The budget limits the award of tenant protection vouchers to the replacement of units that are under lease at the time they are demolished or disposed of. This represents a major shift, since in the past tenant protection vouchers were generally provided to replace all subsidized units, regardless of whether the were occupied at the time the building is demolished or disposed of. Tenant protection vouchers have generally replaced all lost subsidized units because they were intended to compensate a community for the loss of affordable housing resources, in addition to maintaining assistance to specific residents who would otherwise lose aid.

As a result of the proposed shift, communities where some units in a subsidized building are vacant at the time the subsidies are ended will 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. Absent affirmative evidence of the lack of need for affordable housing resources in a community (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 particular communities that lose "hard units." It appears to be merely a way to reduce future federal housing spending.

This change could have particularly harsh implications in the areas affected by the hurricanes of 2005. If a decision is made to demolish or sell damaged public or other assisted housing units in these areas, it will likely occur well after they are no longer technically under lease — even if they were occupied at the time the storm struck. Consequently, the proposed language may call into question whether the pre-hurricane residents of such units are eligible for replacement vouchers.

Hurricane Recovery

The budget does not request funding to restore damaged or destroyed federally assisted housing in the Gulf, except for making a $20 million public housing reserve funding pot potentially available to cover the effects of disasters in 2005. This amount is only a small fraction of what would be needed to repair or replace public housing damaged by the 2005 storms, and in any event is also meant to serve as a contingency fund for disasters in 2007.

Moreover, the budget proposes cuts to some of the existing programs that could have been used to support restoring affordable housing. These include CDBG, the public housing capital fund, and HOPE VI. The elimination of HOPE VI funds and the rescission of funds provided for the program in 2006 are particularly significant for hurricane recovery, because HUD could have chosen to target these funds on hurricane-damaged areas.

The budget also fails to request money specifically to ensure that local housing agencies in the disaster area are able to use their full complement of housing vouchers. The ability of Gulf Coast agencies to use their vouchers is in jeopardy because of rent increases that are pushing up costs and rules that could have made those agencies responsible for the costs of vouchers held by evacuees who remain in other parts of the country. (Even if HUD adjusts the Fair Market Rent standards (which govern the maximum voucher subsidies) for 2007, based on post-hurricane rent changes, under the proposed funding formula agencies' funding allocations would continue to be based on cost data from 2004, adjusted only by formula inflation factors based on costs early in 2005, before the hurricanes struck.)

As mentioned above, the bill does provide HUD with $100 million for portability costs and "unforeseen exigencies" that could potentially could be used to support voucher programs on the Gulf Coast. But this would occur only if HUD chose to use the funds for this purpose, and housing agencies elsewhere in the country also have pressing needs for added voucher funds. In particular, areas where many evacuees have relocated are likely to need additional funds to prevent sharp cutbacks in their voucher programs when special disaster voucher funding ends in the fall of 2007. (In the supplemental appropriations for hurricane relief enacted in December 2005, Congress provided $390 million for section 8 voucher assistance for displaced families that received HUD assistance or were homeless prior to Hurricanes Katrina and Rita. The Administration has just asked for an additional $202 million for this same purpose. But all of these funds expire on September 30, 2007. HUD uses the fiscal year 2007 appropriation to provide housing agencies with voucher funds for the calendar year, so these funds will expire part way through the funding year.)

On February 16, 2006, the Administration submitted to Congress a supplemental appropriations request for $19.8 billion in additional funding for hurricane recovery, separate from the 2007 budget. *None* of the requested funds are targeted specifically on restoration of pre-hurricane affordable housing. It is possible that Louisiana could use some of the $4.2 billion in proposed additional CDBG funds for this purpose, but it would not be required to do so. The request includes $9.4 billion for additional disaster relief funds for FEMA. An unspecified portion of these funds is intended to cover the costs of housing assistance for families displaced by the 2005 Gulf hurricanes, but no changes are proposed that would help low-income people obtain transitional housing in the storms' aftermath.