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REDUCTIONS IN SECTION 8 RESERVES IN HOUSE AND SENATE VA-HUD BILLS WILL LIKELY REDUCE THE NUMBER OF FAMILIES THE VOUCHER PROGRAM SERVES

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Both the Senate and House FY 2002 VA-HUD appropriations bills adopt the Administration's proposal to reduce reserve funds for the Section 8 voucher program from $1.28 billion to $640 million. This Administration proposal was not intended to have adverse effects on the Section 8 program. Unfortunately, however, neither the House bill nor the Senate bill accompanies the reduction in reserve funding with measures that are needed to ensure that public housing agencies (PHAs) will still be able to access adequate reserves — and that adverse effects will not occur. The House bill, in fact, goes beyond the Administration's proposal and includes language that will restrict PHAs' access to reserve funds and likely force some PHAs to reduce the number of families they serve. Although the Senate bill does not include this language, it contains another provision — not present in the House bill or the Administration proposal — that would impair HUD's ability to prevent the reduction in reserve funds from having harmful effects.

The Section 8 reserves provide additional funds to PHAs whose voucher program costs exceed their budget allocations in a given year. Each PHA's budget is based not on its expected costs in the coming fiscal year, but on its actual costs in the prior or second prior year, plus an adjustment for inflation. Because various factors may increase a PHA's costs well above its costs in the base year, reserve funds can be essential to prevent shortfalls in a PHA's budget. For example, recent reform measures that HUD has instituted to improve the Section 8 program, in response to Congressional concerns, will raise the costs that some PHAs face and increase their need for adequate reserves in FY 2002. Changing conditions in the economy and in some housing markets also will raise PHAs' costs.

Reserve funds are particularly important for PHAs that adopt improvements designed to increase voucher "utilization rates." Utilization rates measure the expenditure by PHAs of the voucher funds they have been allotted, and often indicate whether a PHA is assisting families effectively. A PHA may leave a portion of its voucher funds unspent if a significant number of families cannot rent housing with their vouchers, because the subsidy the vouchers provide is too low to cover rent and utility costs for an adequate number of units. In the past, Congress has criticized the voucher program's utilization rates as being too low. Congress also has expressed concern that too many families that succeed in finding units they can rent with their vouchers may be concentrated in high poverty areas. Rents tend to be lower in such areas.

In response to these concerns, HUD has, over the past year, adopted several new policies aimed at increasing voucher utilization and helping families move to less impacted neighborhoods where employment opportunities are greater. These policies generally allow PHAs to increase the size of voucher payments in certain circumstances so a larger supply of rental units will be available to families with vouchers. If a PHA raises its voucher payments to increase voucher utilization and/or to help families move out of areas of concentrated poverty, its costs generally will exceed the base-year costs that HUD uses in calculating the PHA's budget.

Adequate reserves thus are needed to implement voucher reforms. PHAs will not institute reforms if they cannot access adequate reserves and they anticipate that increased utilization may result in a budget shortfall.

In addition to the costs that arise from these reforms, conditions in the economy and local housing markets may raise a PHA's costs. For example, rising housing and utility prices may increase a PHA's cost per voucher in FY 2002 well above the base-year level. A PHA's budget consequently could be insufficient to pay landlords even if the PHA does not increase the number of families it serves. If such a PHA cannot access adequate reserves, it may be forced to reduce the number of families it assists by not reissuing vouchers to new families when existing voucher-holders cease to use them.

When the Administration proposed to reduce the Section 8 reserves, it believed this reduction would not adversely affect the program because $640 million — the amount that would remain in reserve funding — appears sufficient to meet PHAs' need for reserves nationally. Since total reserve expenditures are unlikely to exceed $640 million next year, the Administration's proposal was not expected to produce any outlay savings.

HUD typically divides the reserve funds, however, among the 2,600 PHAs that administer the voucher program. While some PHAs may need little or no reserves, other PHAs are virtually certain to need more than the reduced amount that HUD will allot to them if the reserve is reduced to $640 million. Unless HUD modifies the way it administers the reserves, it will have no mechanism to reallocate reserve funds from those PHAs that do not need the funds to PHAs that are incurring higher costs and need access to more reserve funds. PHAs that anticipate they may exhaust their reserves may seek to avoid shortfalls by failing to implement reform measures or reducing the number of families they serve.

To address this problem and prevent the reduction in reserve funds from undercutting needed reforms and reducing the number of families served, Congress needs to direct HUD to administer the reduced reserve dollars in a way that ensures PHAs can access reserve funds they need to maintain the number of families they serve and achieve better voucher utilization. Neither the Senate VA-HUD bill nor the House bill provides this guidance to HUD.

To the contrary, both bills impede effective administration of the Section 8 reserves. The House bill includes language that explicitly *restricts* HUD's ability to shift reserve funds from

PHAs that do not need them to PHAs that face higher costs. This language will likely result in some shrinkage in the Section 8 program and exacerbate the voucher utilization problem. Although the Senate bill does not contain this restrictive language, it contains another troublesome provision, which would deprive HUD of a potential mechanism to shift unused reserves to PHAs that need additional funds.

Voucher Program Improvements Could Raise Section 8 Costs and Increase Need for Reserves In FY 2002

The voucher program helps families afford rental housing by subsidizing the costs of housing they find in the private market. Families with vouchers generally must contribute 30 percent to 40 percent of their incomes to rent and utilities, with the voucher subsidizing the balance of the costs. If the voucher payments would be inadequate to cover remaining rent and utility expenses, families may be unable to rent units, and a PHA may end its fiscal year with a significant number of unused vouchers. In some areas, families are able to use their vouchers to rent apartments but only in poor neighborhoods with low rents, rather than in neighborhoods with better job opportunities and more adequate schools.

Insufficient voucher payments consequently may cause PHAs to have significant amounts of unexpended voucher funds and low utilization rates. They also may cause voucher-holders to become concentrated in high-poverty areas. PHAs currently can set their voucher "payment standards," which determine the size of the rent subsidies they provide, at a dollar amount between 90 percent and 110 percent of the Fair Market Rent (FMR) for their local rental market. HUD establishes the FMRs annually for all local areas nationwide; it bases the FMRs on the rent and utility costs of the lowest-cost 40 percent of non-luxury units in the area.

In response to Congressional concern about low voucher utilization and concentrations of voucher-holders in poor areas, HUD adopted policies in the past year to adjust FMRs and give some PHAs the authority to increase payment standards where necessary. PHAs that adopt these changes will experience higher costs in 2002 than in the base year used to compute their 2002 budgets. They thus will need access to adequate reserves to implement these reforms.

In January 2001, for example, HUD increased Fair Market Rents in housing markets where data indicate that voucher-holders are becoming overly concentrated in a small number of census tracts. In 39 metro areas that contain about 500 PHAs, HUD raised the FMR to make half of the rental units in these areas affordable to families with vouchers (as opposed to 40 percent of such units). This change enables voucher-holders to move into areas where rents may be modestly higher but more employment opportunities exist and housing is more plentiful. Effective in December 2000, HUD also permitted certain PHAs to increase their voucher payment standards. HUD permitted PHAs to raise these payment standards — and hence the size of voucher payments — if fewer than 75 percent of the families to which a PHA issues vouchers succeed in renting units with the vouchers. Some PHAs adopted higher payment standards under this policy, but not until some time in 2001.

These PHAs' budget allocations for 2002 will be based largely or entirely on the size of the voucher payments they made *prior to* the increases in payment standards they instituted as a result of these policy changes. These PHAs are unlikely to have sufficient funds in their budgets for 2002 to assist the number of families they are authorized to serve. This problem has two primary causes.

- PHAs' budgets for voucher expenditures in 2002 are based on their costs in their last completed and audited fiscal year. PHAs' fiscal years are staggered on a quarterly basis. Depending on a PHA's fiscal-year start date, some or all of the base fiscal year costs used to determine its budget for 2002 expenditures will have been incurred before these new policies took effect.

- It generally takes a year after a PHA increases its payment standards before the full cost of the higher payment standards shows up. That is because the higher payment standard is applied when a family enters the voucher program, when a family moves to a new unit or when a family's rent payment is recalculated, which generally occurs once a year.

For PHAs that increased their voucher payment standard in January 2001, 2002 will be the first year that the full cost of the increased payment standard is reflected in their expenditures for a full 12-month period. Because little if any of this increased cost will have been incurred during the base year used to calculate their 2002 budgets, PHAs that have raised their payment standards to increase voucher utilization are likely to face cost increases that will cause them to need reserve funds during 2002. If these PHAs cannot access adequate reserves, they may be required to reduce the number of families they serve to avoid budget shortfalls.

In addition, 2002 is the first full year in which the Section 8 certificate and voucher programs will be completely merged. Congress mandated this merger in the 1998 housing act to simplify program administration and give families more flexibility in obtaining housing. For many years, the tenant-based Section 8 program has had two components, the certificate program and the voucher program. The programs used different rules to calculate the amount of rent subsidy each family received. In addition, families with certificates were only permitted to rent units below the Fair Market Rent level set by HUD; families with vouchers could rent more expensive units but were responsible for any rent over the subsidy amount. In 1999, when the two-year merger process began, about three-fourths of the families in these programs had certificates.

The merger means that landlords who had contracts with PHAs under the old certificate program have to sign new contracts with PHAs that are governed by the voucher program rules. The certificate program rigidly restricted the rent a landlord may charge for a unit if the landlord wishes to participate in the program; this practice limited the number of rental units available, but also caused some landlords to accept rents below the prevailing rents in their local housing market, particularly for tenants who stayed for a long time. The merger of the certificate program with the voucher program, with the merged program operating under slightly changed voucher program rules, is likely to result in some landlords increasing the rents they charge under their new contracts, since they now will be able to bring their rents in line with rents in the local housing market without losing their ability to participate. This is one more reason that the budgets which some PHAs are allotted for 2002 are likely to prove inadequate and reserves are likely to be needed.

In its report accompanying the FY 2002 VA-HUD bill, the House Appropriations Committee argues that PHAs will not need significant reserves in FY 2002 because they used only $46.2 million in reserve funding in FY 2000. The figure for FY 2000, however, is not a good indicator of PHAs' need for reserves in 2002. First, it does not reflect the effect of the recent policy changes discussed above. Second, FY 2000 was the first year in which PHAs operated under a new policy regarding access to reserve funds. The new policy was necessitated by a fundamental change in the way that PHA budgets are calculated. For many years, PHAs operated under multi-year contracts for Section 8 funding with HUD, rather than under the type of annual budgets now used. The assumptions that HUD used to calculate these multi-year funding arrangements enabled PHAs to build up significant untapped funds that, in effect, functioned as reserves. As PHAs made the transition to annual budgets, HUD needed a new policy to protect PHAs against the budget shortfalls that can occur from year to year. HUD consequently established the current policy regarding reserves. The new policy on reserves was not established in regulation until January 1, 2000, however, and HUD did not issue a notice to PHAs explaining this new reserve policy and how they could draw down up to two months' worth of reserve funding until April 2000. Because the policy was new and notification to PHAs did not occur until FY 2000 was half over, PHAs were unlikely to use this new policy — and to access reserves — to any significant degree in FY 2000.

Changes in the Economy, Housing Markets, and Utility Costs May Raise Costs In 2002

Housing authorities have to be responsive to local housing markets to make sure that the subsidy a voucher provides is adequate to help families afford adequate housing. In tight housing markets with escalating rents, PHAs may need to increase voucher payment standards to keep pace with rising rents. If PHAs do not increase their payment standards, an increasing share of families may be unable to use their vouchers, and voucher utilization may decline.

Recent data point to continued price increases in rental markets. A recent report of the Joint Center For Housing Studies at Harvard states: "Rental markets tightened again in 2000, pushing rents up faster than general inflation for the fourth consecutive year."[1] The report concludes that this housing affordability problem is likely to worsen in the decade ahead.

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[1] Joint Center for Housing Studies, *The State of the Nation's Housing 2001* at 18.

Furthermore, because voucher payments are based on gross rent (rent plus reasonable utility costs per unit), recent increases in gas and electricity prices will further increase PHAs' cost per voucher. Many PHAs will need to adjust their payment standards not just to keep pace with rents, but also to accommodate rising utility prices. Beginning in July 2001, HUD is allowing PHAs in areas with substantial increases in utility costs to raise their payment standards. These increases could be in effect for all of 2002. They will not be reflected in the base-year costs used to compute PHAs' budgets for 2002.

In addition to escalating housing and utility costs, PHAs are likely to face higher costs as a result of the recent economic downturn. A sluggish economy will cause some families to lose their jobs or earn lower incomes in the year ahead. Reduced incomes result in smaller rent contributions. Families are required to contribute a minimum of 30 percent of their income for rent and utilities; when incomes fall, the amount that families pay decreases, and the cost that a PHA incurs for these families increases.

Other factors also can raise a PHA's costs. PHAs often must over-issue vouchers to achieve full utilization. Invariably, some families will not use the vouchers they are issued (because they are unable to find units to rent with their vouchers or for other reasons). Similar to the way that airlines over-book flights to try to fill every seat, PHAs often compensate for an inevitable number of unused vouchers by over-issuing vouchers to promote full utilization. This generally causes fewer voucher resources to go unused. On rare occasions, more families use their vouchers than a PHA anticipated and the PHA must subsidize more families than authorized by its budget. In these unusual situations, a PHA's costs will exceed its budget and the PHA must use reserve funds as an appropriate short-term remedy. (In these cases, only a short-term remedy is needed, as PHAs in this situation must reduce the number of families they assist. As families cease to use their vouchers, the vouchers are not reissued to new families until the PHA has brought its costs in line with its budget.) The key point here is that if PHAs can not count on having adequate reserves upon which to rely if necessary, they may be less inclined to over-issue vouchers to enable them to serve the full number of families authorized. The likely result would be fewer families receiving voucher assistance and an increase in unutilized voucher funds.

Changes in the mix of families that a PHA serves in a given year also can cause costs to rise, particularly for smaller PHAs. Larger families need larger units, and the vouchers provided to these families carry a higher average cost. If a small PHA finds it needs to serve a somewhat larger number of large families in a given year, it would face costs that exceed those it incurred in the base year.

How the Reserves Work and the Effect of the House and Senate Bills

Currently, PHAs have access to two months of reserve funding beyond their 12-month budgets. When a PHA realizes that its costs to continue paying landlords participating in the program are exceeding its budget, it can request an increase in its annual budget. HUD may approve up to two months worth of additional funding from the reserve.

Historically, HUD has administered the reserves in a manner that gives each PHA its own "piece" of the reserve funds. HUD treats the reserves as though these funds are divided into 2,600 accounts (the number of PHAs administering voucher programs), with each account containing two months of reserve funds.

The President's budget request and the House and Senate VA-HUD bills cut the Section 8 reserves in half, to $640 million. If HUD administers the reserves as it has in the past, it will divide these reduced dollars into 2,600 portions equal to one month, rather than two months, worth of reserves — effectively halving the amount of funds each PHA can access. A PHA whose costs exceed a one-month reserve — as may be the case for a number of PHAs that have instituted reforms to use their vouchers more fully — would not have access to adequate reserves. *Yet many other PHAs would not be exhausting their reserves, and substantial reserve funds would remain unused nationally*.

HUD is not required by law to treat the reserves in this manner. HUD could create a central, "headquarters" reserve in addition to, or instead of, the individual reserves it holds for each PHA. This central reserve would provide additional funds to those PHAs with rising costs rather than spreading one month of funds over every PHA, including those that are operating within their budget allocations and do not need reserve funds.

There are a number of different ways in which HUD could administer a central reserve. It could recapture unused Section 8 funds more frequently and use the recaptured funds to replenish a headquarters reserve on an ongoing basis. Currently, HUD only recaptures unused funds annually, toward the end of the federal fiscal year. (Because PHAs' fiscal years end at various times throughout the calendar year, HUD could identify PHAs that have completed their fiscal years and have unused voucher funds. HUD could recapture those funds well in advance of the end of the federal fiscal year and shift those unused resources to the PHAs that need additional funding.)

HUD does not need to use recaptured funds to create a headquarters reserve (although this approach has the benefit of shifting unused resources from PHAs that do not need all of their voucher funds to PHAs that are taking steps to serve families more effectively). HUD also could finance a headquarters reserve simply by setting aside a modest portion of the $640 million provided for Section 8 reserves as a headquarters fund and dividing the remainder among the PHAs.

House and Senate Bills Do Not Authorize A Central Reserve

Because HUD historically has administered the reserves by providing each PHA with its own funding pot, it is unlikely to change this practice without Congressional authorization and direction. HUD will probably argue it lacks authority to create a central reserve that would be safe from Congressional rescission unless Congress provides it with this authority in the appropriations act.[2] Congress should make clear its intent that HUD administer the reduced reserve in a way that ensures PHAs can access adequate reserve funds to maintain the number of families they serve or to increase utilization rates. Neither the House bill nor the Senate bill — or either committee report — includes language authorizing a central reserve. Similarly, neither the House nor the Senate bill or committee report clearly directs HUD to ensure access to reserves for PHAs that need additional reserve funds.

In fact, the House VA-HUD appropriations bill contains language that explicitly *prevents* HUD from creating a headquarters reserve or taking any other approach to ensuring adequate reserves. The House bill states that "(HUD) shall reduce from sixty days to thirty days the amount of reserve funds made available to public housing authorities." This language is likely to be interpreted by HUD as imposing upon it a requirement to divide the reserve into a separate 30-day fund for each PHA. As a result, PHAs needing more than one month of reserves to continue providing assistance to the number of families they are authorized to serve would be unable to draw on the reserves of other PHAs that do not need reserve funds. Such PHAs could face budget shortfalls and be compelled to reduce the number of families they serve or to scale back efforts to increase voucher utilization.

The House language goes well beyond the Administration's interest in proposing to reduce the Section 8 reserves. The Administration believed it was cutting reserve funds that would not be needed or used. Because total reserve expenditures by PHAs nationally are unlikely to exceed $640 million, this reduction was not expected to affect the number of families served with vouchers. Indeed, the Administration assumed the reduction in reserves would produce no outlay savings; it would generate savings only in budget authority. Outlay savings could be secured only if the reduction in reserve funding forced PHAs to decrease expenditures on their voucher programs by serving fewer families.

It is noteworthy therefore that CBO has determined the House language *would* produce outlay savings. The CBO estimate confirms that the House bill essentially ensures that some PHAs will reduce the number of families they serve because they cannot access needed reserves. As a result, the overall number of families receiving voucher assistance in 2002 will decrease if the House language is retained.

The Senate VA-HUD bill does not contain this restrictive language. In fact, the report accompanying the Senate VA-HUD bill expresses the concern of the Senate Appropriations

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[2] HUD is authorized to establish what is in effect a headquarters reserve by the voucher statute (see 42 U.S.C. § 1437f(o)(1)(C)). HUD has never used this authority, mainly due to its perception that a central fund would be an easy target for rescission by Congress. It is therefore critical that Congress specifically authorize a central reserve and clearly express its intent that such a fund be used to increase utilization and help PHAs serve the authorized number of families. A central fund also requires HUD to take a more active administrative role with regard to the reserves than is its current practice. To ensure that HUD takes this more active role, Congress will need to direct HUD to administer the reserves in such a fashion that PHAs needing additional funds can access adequate reserves.

Committee that the reduction in reserve funds could reduce voucher utilization. The report states:

> The Committee is very concerned about HUD's policy to reduce the amount of section 8 reserves held by public housing agencies by one-half. The Committee believes that this reduction may limit the ability of some PHA's to provide section 8 assistance to families with severe housing needs and is counter productive to the reforms made by this Committee in recent years that would make section 8 assistance better utilized.[3]

But the Senate bill includes this reduction anyway and takes no steps to address the concerns that the report expresses. The bill does not direct HUD to manage the reserves so PHAs needing access to more than one month of reserves can secure the necessary funds. Furthermore, the Senate bill contains a provision that would exacerbate this problem: it rescinds *all* Section 8 funds from 2002 and prior years that HUD recaptures in the future. (This rescission applies not only to voucher funds recaptured from PHAs, but also to funds recaptured from HUD's contracts with private owners under the project-based Section 8 program.)

As discussed above, HUD could finance a headquarters reserve by using a more frequent recapture process to secure funds for PHAs that need more than one month of reserves. By rescinding the funds obtained by such recaptures, however, the Senate bill effectively prevents HUD from using this approach as a way to ensure that unused voucher funds can be accessed by PHAs that need more reserve funds. The Senate bill consequently deprives HUD of an important tool for ensuring that PHAs can access adequate reserves. (The Senate rescission may have significant adverse impacts on the Section 8 program in other ways as well, beyond impairing HUD's ability to finance adequate reserves. The potential effect of this rescission is examined in another Center analysis, "Senate Va-HUD Appropriations Bill Makes Damaging Changes in Section 8 Housing Program For Low-Income Households."

Congress Should Advance Policies to Ensure that PHAs Can Access Adequate Reserves

Like other Appropriations Committee reports of recent years, the House and Senate Appropriations Committee reports accompanying the FY 2002 VA-HUD appropriations bills cite the problem of unused vouchers and urge that more be done to address the problem. But despite these sentiments, Congress appears poised to reduce the Section 8 reserves and institute other policies that would undercut PHAs' ability to increase voucher utilization rates and reform the program so it serves families more adequately. Rather than institute policies that will restrict access to adequate reserves and cause some PHAs to cut their programs — even while other PHAs have reserves they don't need and cannot use — Congress should direct HUD to administer the scaled-back reserve funds in a way that ensures PHAs that need more than one month of reserves will be able to access the necessary funds.

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[3] Senate Report No. 107-43, July 20, 2001 at 28.