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TESTIMONY OF BARBARA SARD
Director of Housing Policy, Center on Budget and Policy Priorities
Senate Banking Subcommittee on Housing and Transportation, April 25, 2001

Executive Summary

This testimony addresses the Administration's budget for the Department of Housing and Urban Development, particularly the proposals concerning the Section 8 voucher program.

The strong economy during much of the 1990s helped lead to significant increases in homeownership and an eight percent drop from 1997 to 1999 in the number of households with "worst case" housing needs. (HUD defines renters as having "worst case" housing needs if they are unsubsidized renter households who have incomes at or below 50 percent of the area median income and pay more than half of their income for rent and utilities or live in severely substandard rental housing.) Nevertheless, 4.9 million households fell into this category in 1999. In addition, the strong economy contributed to a continuing decrease in the number of affordable housing units on the private market and a reduction in the number of housing units potentially available to families with Section 8 vouchers.

Without additional resources, millions of families — including those leaving welfare for work — will remain unable to obtain decent-quality housing that they can afford or that is located near jobs. In many areas and for many families, new housing must be constructed or run-down housing fixed up to solve of the problems of poor housing quality, overcrowding, and the low vacancy rates that are driving up prices. Any effort to produce or rehabilitate additional housing should focus primarily on extremely low-income households, as these are the households with the greatest needs. Rental assistance alone can remedy the housing affordability problems of about three-fourths of the households considered to have the most severe housing problems. To meet these needs, a substantial increase in housing vouchers is needed.

One-sixth of all households in the U.S. are renters with moderate or severe housing problems. Relatively few of these renter households will benefit from the Administration's proposed homeownership initiatives. Some want to continue to rent, at least temporarily, and for many, homeownership is not financially feasible. Yet the Administration's HUD budget request largely fails to respond to the need for additional affordable rental housing. The Administration's request for 33,700 additional vouchers is a positive step but does not go far enough in light of the magnitude of unmet needs. The requested increase is less than 40 percent of the 87,000 additional vouchers approved for fiscal year 2001 (79,000 "fair share" vouchers and 8,000 for the disabled). Further, the proposed reduction of 10,000 "tenant protection" vouchers compared with fiscal year 2001 may cause a decrease in the supply of federally assisted housing.

In addition, rather than renewing all expiring Section 8 voucher contracts between HUD and PHAs, as it purports to do, the Administration's budget may lead to a reduction in the number of families served by the voucher program. The Administration's budget proposes to

reduce PHAs' reserves for the Section 8 program from two months to one month of annual budget authority in FY 2002. This change "saves" $640 million, which the Administration uses to offset the cost of renewing Section 8 contracts in FY 2002.

This proposed reduction in Section 8 reserves may require PHAs with significant cost increases to reduce the number of families they serve. A substantial proportion of PHAs may face increased costs in 2002 for a number of reasons. For example, PHAs may increase their voucher payments to keep pace with an increase in the HUD-determined Fair Market Rent or with rising local rents and utility costs. Small agencies are vulnerable if the cost of assisting a few families increases due to larger family size or moves to higher-cost areas. The completion of the merger of the certificate and voucher programs late this year may increase average subsidy costs. If sufficient funds are not available to meet these cost increases, either through individual PHAs' reserves or a central fund, PHAs will not be able to provide vouchers to the total number of families Congress has agreed to assist.

In addition, if the reduction in program reserves deters PHAs from increasing voucher payments when rents and utility costs increase, fewer families may be able to obtain housing with their vouchers and more voucher funds may remain unutilized.

TESTIMONY OF BARBARA SARD
Director of Housing Policy, Center on Budget and Policy Priorities
before the
Senate Banking Subcommittee on Housing and Transportation
April 25, 2001

I appreciate the invitation to testify today. I am Barbara Sard, director of housing policy for the Center on Budget and Policy Priorities. The Center is a nonprofit policy institute here in Washington that specializes both in fiscal policy and in programs and policies affecting low- and moderate-income families.

My testimony today focuses on the Administration's budget for the Department of Housing and Urban Development in the context of the persistence of affordable housing shortages and unmet housing needs for low-income families and individuals. The testimony also discusses the critical link between affordable housing and welfare reform and examines the Administration's proposals concerning the Section 8 voucher program.

Affordable Housing Shortage and Unmet Housing Needs[1]

The strong economy during much of the 1990s helped lead to significant increases in homeownership and an eight percent drop from 1997 to 1999 in "worst case" housing needs among very low-income renters. (HUD defines renters as having "worst case" housing needs if they are unsubsidized renter households who have incomes at or below 50 percent of the area median income and either pay more than half of their income for rent and utilities or live in severely substandard rental housing.) The strong economy had its downside as well, however, contributing to the continuing decrease in the number of affordable housing units on the private market. Between 1997 and 1999, the total number of units affordable to renters with very low incomes — those with incomes below 50 percent of the area median income — fell by 1.1 million, a 7 percent decline in just two years. The supply of rental housing is of major importance because one of every three households is a renter.

Despite increased involvement in the labor market, millions of poor and near-poor families remain unable to afford decent housing. The most recent data from the American Housing Survey show that in 1999, some 4.9 million very low-income renter households that did not receive housing assistance paid more than half of their income for rent and utilities or lived in severely substandard housing. This means that the 10.9 million people in these households — including 3.6 million children, 1.4 million elderly, and 1.3 million disabled adults — have severe housing needs that the nation's economic progress has not remedied.

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[1] The data for this testimony have been culled from analyses of the 1999 American Housing Survey by HUD staff and by Cushing Dolbeare on behalf of the National Low Income Housing Coalition. See U.S. Department of Housing and Urban Development, *A Report on Worst Case Housing Needs in 1999: New Opportunity Amid Continuing Challenges*, January 2001; U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *U.S. Housing Market Conditions*, November 2000; and Cushing N. Dolbeare, "Low Income Housing Profile," *2001 Advocate's Guide to Housing and Community Development Policy,* National Low Income Housing Coalition, March 2001.

Nonetheless, work effort among households with worst case housing needs has increased. In 1999, 80 percent of households with worst case housing needs that had an adult who was not elderly or disabled relied on earnings as their primary source of income, compared with 74 percent of such households in 1997.[2]

The only severe housing problem for more than three-fourths of the households with worst case housing needs is paying more than half of their income for housing. Another 17 percent pay more than half of their income to live in physically inadequate or overcrowded housing.

Many communities have experienced an accelerating loss of affordable rental units in recent years due to escalating rents, conversion of rental housing to other uses, or abandonment. The number of units affordable to renters with incomes below 30 percent of the area median income dropped by 750,000, or 13 percent, between 1997 and 1999. (The number of units affordable to households with incomes between 31 percent and 50 percent of the area median income also declined.) Some 400,000 such units either ceased to be used as rental housing or increased in price sufficiently as to become unaffordable for such households. In every region of the U.S., but especially in the West and the Northeast, rental housing affordable to renters with incomes at or below 30 percent of the area median income was in shorter supply than housing affordable to other income groups.

These changes in the housing market also have reduced the number of housing units potentially available to families with Section 8 vouchers. Between 1997 and 1999, the number of units with rents below the HUD-determined Fair Market Rent (FMR) dropped significantly.[3] Vacancy rates for units renting at or below the applicable FMR fell in every region except the Midwest. In all regions, the units in shortest supply were those with three or more bedrooms and rents below FMR, making the search for housing particularly difficult for voucher holders with three or more children. In every region, suburbs had the lowest vacancies in units renting below the FMR. These are the areas that are most likely to have the greatest job growth.

In addition, recent anecdotal evidence from many areas suggests that vacancy rates have declined far below the five percent level that is generally considered the minimum for a healthy rental market. For example, recent studies have shown that the rental vacancy rate in the Denver metropolitan area in the last quarter of 2000 was 4.7 percent. In the period from September 2000 to February 2001, the rental vacancy rate outside of the Denver metro area fell from 4.1 percent

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[2] The analysis of the 1997 AHS data by the Joint Center for Housing Studies of Harvard University contains more detail on working families than HUD's latest report. Among unsubsidized, very low-income renters with earnings that equal or exceed the equivalent of full-time employment at the federal minimum wage ($10,300 per year), 71 percent paid more than 30 percent of their income for housing. Most of these cost-burdened families paid more than half of their income for rent and utilities. Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2000.*

[3] The Fair Market Rent, determined annually by HUD, generally is equivalent to the rent for the bottom 40 percent of non-luxury units available for rent in the prior two years. In January 2001, HUD increased the FMR in 39 metropolitan areas to cover half of the rental units (50th percentile).

— already very low — to 3.2 percent. Not surprisingly, rents have escalated in these tight housing markets. The average rent in the Denver area was $792.67 at the end of 2000, an increase of 8.1 percent over the previous year. Statewide, rents rose 4.9 percent, to an average of $753.[4] Finding available low-rent housing has become a difficult proposition in many urban and suburban communities alike.

Renter households with incomes below 30 percent of the area median income have by far the greatest incidence of acute housing problems. Fully 87 percent of these renters — some 6.8 million households — had severe or moderate housing problems in 1999. (Moderate housing problems include paying more than 30 percent of income for rent and utilities, overcrowding, and physical deficiencies that are not considered severe.) More specifically, 65 percent of extremely low-income renters had severe cost burdens, 14 percent had moderate cost burdens, 15 percent lived in physically defective housing, and 6 percent lived in overcrowded conditions. Some had multiple problems. (These data include a substantial number of households receiving housing assistance.) The vast majority of the households living in physically defective or overcrowded housing also were paying more than 30 percent of their income to rent such inadequate housing.

What should we learn from these data? Even if a rising tide were to continue and were to lift all boats, so to speak (and there is increasing evidence that neither assumption can be relied on), the boats of far too many of our citizens would still be leaking. That is, even if their incomes did rise, millions of extremely low-income families would remain unable (without additional resources) to obtain decent-quality housing that they can afford. In many areas and for many families, new housing must be constructed or run-down housing fixed up to solve the problems of poor housing quality, overcrowding, and the low vacancy rates that are driving up prices. Any effort to produce or rehabilitate additional housing should focus primarily on extremely low-income households, as these are the households with the greatest needs. For other areas and other families, rental assistance alone will remedy their housing problems.

Lack of Affordable Housing May Undermine Welfare Reform Efforts

Most families that leave welfare for work do not earn enough to afford decent-quality housing. Typically, households that previously received welfare benefits and have at least one working member earn less than $3,500 per quarter; many studies report average earnings far below this amount.[5] Even if these earnings continue without periods of unemployment or underemployment, which is unlikely, families with incomes of $14,000 per year typically must

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[4] Kristi Arellano, "Rents gain 8% in tight market," *Denver Post,* January 25, 2001; Tom McGhee, "Apartment vacancy rates dip, rents up outside metro area," *Denver Post,* April 10, 2001.

[5] See studies gathered in Barbara Sard and Jeff Lubell, *The Increasing Use of TANF and State Matching Funds to Provide Housing Assistance to Families Moving from Welfare to Work,* Center on Budget and Policy Priorities, February 2000, p. 18, notes 46–49, available on the internet at http://www.cbpp.org/2-17-00hous.pdf, and in U.S. Department of Health and Human Services, Office of Assistant Secretary for Planning and Evaluation, *"Leavers" and Diversion Studies: Summary of Research on Welfare Outcomes Funded by ASPE,* available on the internet at http://aspe.os.dhhs.gov/hsp/leavers99/ombsum.htm. Studies of welfare leavers' household incomes generally look at income on a monthly or quarterly basis, rather than annually.

pay more than half of their income for decent housing if they do not have housing assistance.

On average, a family must earn at least $12.47 per hour of full-time work — about $25,000 per year — to afford a two-bedroom housing unit at the Fair Market Rent. In no county, metropolitan area, or state does a family earning the equivalent of full-time employment at the minimum wage have enough income to pay the Fair Market Rent for housing with one or more bedrooms without spending more than 30 percent of its income for rent and utilities.[6] (Federal guidelines set during the Reagan Administration provide that rental housing is affordable when the costs of rent and utilities do not exceed 30 percent of a family's adjusted income.)

High housing costs can leave families with insufficient remaining income for basic necessities or to pay for child care, clothing for work, transportation, and other expenses that often must be met for families to move from welfare to work. In addition, families that pay too much of their income for housing or live in severely inadequate or overcrowded housing may have to move frequently. Such moves may interrupt work schedules, jeopardize employment, and adversely affect children's educational progress. A recent study in Ohio found that 42 percent of families that had recently left welfare and paid more than half of their income for housing moved in the six-month period after leaving welfare. (In contrast, roughly eight percent of the general population moves in a six-month period.)[7]

Conversely, lack of housing subsidies or other assistance can prevent families from making moves that could improve their economic prospects, such as moves to areas with greater employment opportunities or areas where parents feel safe enough to go to work and leave older children unattended or return from work at night on public transportation.

As these facts suggest, affordable housing may enhance welfare reform efforts. Research increasingly suggests that vouchers and other government housing subsidies can promote work among long-term welfare recipients when combined with a well-designed welfare reform program. Of particular note is the recently released evaluation of the Minnesota Family Investment Program (MFIP) by the Manpower Demonstration Research Corporation. Taken as a whole, the gains it found — including reductions in poverty, increases in employment and earnings, and even increases in marriage — are among the strongest ever documented for a welfare reform undertaking in the United States.

Most of MFIP's success was due to the substantial increases in employment and earnings it generated among families receiving housing assistance (primarily Section 8 vouchers); families without housing assistance had little or no gains. This is one of a growing number of studies that find significantly greater welfare reform effects among families with housing vouchers (and

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[6] National Low Income Housing Coalition, *Out of Reach 2000: The Growing Gap Between Housing Costs and Income of Poor People in the United States*, September 2000, available on the internet at www.nlihc.org .

[7] Claudia Coulton *et al.*, *Issues of Housing Affordability and Hardship among Cuyahoga County Families Leaving Welfare Quarter 4, 1998 - Quarter 3, 1999,* Center on Urban Poverty and Social Change, Special Topics in Welfare Reform Report No. 1, 2001.

sometimes other forms of housing assistance) than among other low-income families, suggesting that housing assistance may enhance the effects of welfare reform strategies in promoting employment.[8]

The current shortage of affordable housing and the critical link between housing and welfare reform underscore the need for additional funds for housing vouchers and for production of new rental housing. The fact that millions of families are paying a disproportionate share of their income on rent or are living in substandard housing should signal that significant investments in low-income housing programs are overdue. Failure to make such investments will only exacerbate these problems.

The HUD Budget Proposals

The Administration's new housing budget proposals must be examined in light of the affordable housing shortage, the millions of families with worst case housing needs, and the apparent importance of affordable housing to helping families move from welfare to work. Other witnesses today will explain how proposed reductions in public housing funds may, in the short run, reduce the quality of life for families with children and elderly and disabled individuals living in public housing, and over time may reduce the number of livable public housing units.

I will address the Administration's housing voucher proposals. In particular, I will discuss the proposal to increase the number of families and individuals receiving housing vouchers by less than 40 percent of the number of additional vouchers funded in 2001. In addition, I will discuss why the proposed halving of Section 8 reserve funds may, if enacted without change, result in fewer families receiving voucher assistance without an explicit decision by Congress to take such a step. Reducing Section 8 reserves also is likely to make it more difficult for families that do receive vouchers to use them, particularly in areas with greater employment opportunities.

Additional Vouchers: Less than 40 Percent of the Number Funded in FY 2001

The Administration's budget includes a request for $197 million for 33,700 additional Section 8 vouchers. While we strongly support the funding of additional vouchers, we

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[8] Center on Budget and Policy Priorities, "Research Evidence Suggests That Housing Subsidies Can Help Long-term Welfare Recipients Find and Retain Jobs," June, 2000, available on the internet at http://www.cbpp.org/6-27-00hous.htm; Cynthia Miller, Virginia Know, Lisa A. Gennetian, Martey Dodoo, Jo Anna Hunter, and Cindy Redcross, "Reforming Welfare and Rewarding Work: Final Report on the Minnesota Family Investment Program, Vol. 1: Effects on Adults." New York: Manpower Demonstration Research Corporation, August 2000. See also, Barbara Sard and Jeff Lubell, *The Value of Housing Subsidies to Welfare Reform Efforts,* Center on Budget and Policy Priorities, February 2000, available on the internet at http://www.cbpp.org/2-24-00hous.htm.

respectfully suggest that this proposal is inadequate in light of the magnitude of families' needs and the essential role of vouchers in a comprehensive housing strategy.

The Administration's proposed increase in the number of vouchers is less than 40 percent of the number of additional vouchers funded in 2001. In the fiscal year 2001 budget, Congress provided funding for 79,000 so-called "fair share" housing vouchers, as well as 8,000 new vouchers for disabled applicants. ("Fair share" vouchers are new vouchers that are distributed to housing agencies based on a formula allocation to the state or area level and limited competition by agencies within the allocation areas. In some years Congress has set aside new vouchers for special populations, such as the Welfare-to-Work vouchers funded in FY 1999.) Since both sets of new vouchers represent additions to the overall supply of federal housing subsidies, the total number of new vouchers funded in fiscal year 2001 is 87,000. In contrast, the Administration has proposed only 33,700 "fair share" vouchers and no additional vouchers for disabled applicants.

The HUD briefing book states, "PHAs will be encouraged to provide up to $40 million in voucher funds for non-elderly disabled persons." It is unclear what steps HUD intends to take and what the likely results may be. The most that PHAs could be asked to do, however, would be to move disabled applicants ahead of others on their waiting lists. Encouraging PHAs to rearrange their waiting lists does not increase the supply of housing assistance – it only serves to delay further the receipt of voucher assistance by other applicants.

10,000 Fewer "Tenant Protection" Vouchers

In addition, the Administration's budget reduces another component of new voucher funding in comparison with the fiscal year 2001 budget approved by Congress. The Administration seeks funding for only 30,300 "tenant protection" vouchers in FY 2002. For the current year, Congress appropriated funding for 40,300 "tenant protection" vouchers — 10,000 more than the Administration proposes.

Tenant protection vouchers provide continuing housing assistance when public housing is demolished or private owners terminate their HUD contracts. If such vouchers are distributed only to families that previously received federal housing assistance, they do not count as "incremental" (or additional) vouchers because the overall number of federally-assisted units is not increased. When PHAs receive vouchers to replace previously unoccupied public housing units, however, tenant protection vouchers represent a real increase in the number of households receiving federal housing assistance.

HUD may anticipate fewer public housing demolitions and/or fewer private owners opting out of Section 8 contracts in FY 2002 than in recent years, and thus less need for tenant protection vouchers. However, HUD has not provided a rationale for the reduced request and it is not clear why there would be less need for such vouchers next year.

The reduced request for tenant protection vouchers may mean that HUD does not intend to provide new voucher funding to replace previously unoccupied units that are demolished with

HOPE VI funds. (The HOPE VI program, Section 24 of the US Housing Act, promotes the creation of mixed-income neighborhoods by providing funding for the demolition and reconstruction of seriously deteriorated public housing.) HUD's policy has been to provide such replacement vouchers when requested by a PHA, in order not to reduce the supply of assisted housing in a community. The proposed budget language, however, deletes HOPE VI from the list of the purposes for which tenant protection vouchers may be issued.

In addition, HUD may expect that new voucher funding to relocate families in conjunction with HOPE VI demolition or revitalization grants will come from the HOPE VI account. This, however, would force PHAs either to reduce the amount of HOPE VI grant funds available for construction of replacement public housing units or to relocate families using vacant public housing units in other developments or vouchers that become available through turnover. Either choice would result in a net reduction in the supply of federally-assisted housing, as the number of newly constructed or rehabilitated public housing units plus new vouchers would be less than the number of public housing units demolished.

Potential Problems with Reduction of Section 8 Reserves From Two to One Month

The Administration's budget proposes to reduce PHAs' reserves for the Section 8 voucher program from two months to one month of annual budget authority in FY 2002. This proposal "saves" $640 million in budget authority, which the Administration uses to offset the cost of renewing Section 8 voucher contracts between HUD and PHAs in FY 2002. While this proposal may appear to be harmless, it could result in a silent reduction in the number of families receiving voucher assistance. It also may discourage PHAs from taking the actions necessary to use all their voucher funds and to facilitate families' moves to better neighborhoods. In 1999, senior HUD staff expressed their belief that the two-month reserve is necessary and that reducing it to four weeks would represent "a serious threat to housing the baseline families."[9] HUD has not released any analysis indicating a basis to change this conclusion.

At best, the Administration's proposal would result in only a one-time savings of budget authority and would make no difference in outlays. For the FY 2003 budget, an additional $640 million in budget authority (plus inflation) would be required to renew Section 8 contracts in comparison with FY 2002, on top of the increase that will otherwise be required to renew additional expiring contracts and maintain assistance to the same number of families. In short, today's "savings" may set up tomorrow's program cut.

The paramount goal in considering the Administration's proposal should be to keep the commitment to renew fully *all* expiring Section 8 contracts. This requires the appropriation of sufficient funds to provide voucher assistance to the total number of families that Congress has authorized over the years. If access to reserves is restricted, agencies with annual budgets that do not include sufficient funds to meet increased costs may be required to reduce the number of families served and possibly to terminate rental assistance payments to property owners, causing families to lose their housing.

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[9] See Summary of the Negotiated Rulemaking Session of July 19-20, available on the internet at http://www.hud.gov/pih/programs/s8/jul19-20.pdf, page 3.

Even for agencies that do not need to draw on reserve funds to maintain assistance to families, the reduction in reserves may discourage adjustments in voucher payments to meet rising rent and utility costs. If agencies do not increase voucher payments despite increased housing costs, more families may be unable to use their vouchers or may be restricted to areas of poverty and minority concentration. As a result, the Administration's proposal to reduce Section 8 reserves by half may undercut efforts to increase the utilization of voucher funds and to make families' search for housing more successful.

Below is a brief explanation of why up to two months reserves may be important for the effective operation of the voucher program.

The Role of Reserves in the Renewal of Section 8 Funding

Most Section 8 voucher contracts between HUD and PHAs are annual. Under the current system of renewing voucher contracts, a PHA receives a budget allocation in advance of the calendar year based on its prior fiscal year's average cost per month for each family assisted.[10] HUD adjusts the prior year's average cost for inflation and multiplies the adjusted average cost by the number of vouchers the PHA is authorized to administer. If a PHA's costs in 2002 are much higher than the base year's costs plus the inflation adjustment, it will not have enough funds in 2002 to pay landlords unless it reduces the number of families it serves.

The negotiated rulemaking panel that helped HUD develop the new renewal policy recognized the weakness of a methodology that calculates the cost of renewing voucher contracts based on previous average costs. (I was a member of that panel.) To remedy this problem, access to reserves is a linchpin of the new renewal policy. Each year, HUD generally sets aside an amount equal to two months of each PHA's annual budget as program reserves. If a PHA has not used any of its reserves in the previous year, the existing reserve is merely adjusted to be equal to two months' worth of a given year's budget. PHAs that have not been found by HUD to have serious management deficiencies may draw on at least one month's reserve, and a second month with HUD approval, to meet the costs of assisting the authorized number of families. (If a PHA uses its reserves to serve additional families, in excess of the number authorized by HUD, HUD will not reimburse the PHA and the PHA will have to operate with reduced reserves.)[11]

Reasons a PHA's Average Costs May Increase

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[10] The renewal formula may be based on actual costs two fiscal years previously, depending on the timing of the PHA's fiscal year in relation to the calendar year, the PHA's provision of an audited year-end statement to HUD, and HUD's review.

[11] HUD explained the critical role of PHAs' increased flexibility to access reserves and how the new reserve policy works in a notice issued April 19, 2000. See 65 Fed. Reg. 21,090.

A PHA's average cost to provide housing assistance through the voucher program may increase from year to year for a number of reasons. (Average costs also may decrease, but decreased costs do not require the use of reserves.) The most obvious is an increase in the voucher payment standard, which determines the maximum amount a PHA contributes for a family's rent and utility costs. Generally, PHAs set the payment standard between 90 and 110 percent of the HUD-determined Fair Market Rent; they may set the payment standard higher or lower with HUD approval.

HUD publishes FMRs annually. When rent and utility costs are increasing, FMRs are likely to increase as well, and PHAs are likely to increase their payment standards in response. A PHA also may exercise its discretion to increase its payment standard in light of escalating housing and utility costs.

PHAs in areas hit by rapidly rising rents and/or utility costs could be forced by a reduction in reserves to choose between a needed increase in the payment standard and a reduction in the number of families they can assist. If a PHA keeps payment standards down, families that receive vouchers may not be able to use them and those that already have voucher assistance will have to pay an increased share of income if rent or utility costs increase. If a PHA increases its voucher payment standards and has no reserves to draw upon, families on the waiting list will have to wait longer to receive assistance.

In January 2001, HUD increased FMRs substantially in many areas to expand the areas in which voucher holders locate within a metropolitan area and to enhance the likelihood that families will succeed in using their vouchers. Specifically, HUD increased the FMR from the 40^{th} percentile to the 50^{th} percentile in 39 metropolitan areas that contain about 500 PHAs. HUD made this change based on data indicating that in these areas, Section 8 users were overly concentrated in a small number of census tracts. In calendar year 2002, these PHAs will receive renewal funding based at least in part, and possibly entirely, on their costs prior to the FMR increase. They are unlikely to have sufficient funds within their annual budgets to assist the number of families they are authorized to serve without using reserves.

Similarly, beginning in October 2000 HUD has permitted PHAs with voucher success rates below 75 percent to increase their payment standards as if their FMRs had been increased to the 50th percentile. Agencies that have done so will need to access reserves to avoid cutting the number of families served. Reducing Section 8 reserves in 2002 from two to one month may undermine the gains achieved through these changes.

HUD has indicated that the FY 2002 FMRs are likely to be substantially higher in many areas due to increased rents and utility costs. To implement the increased FMRs without reducing program size, more PHAs are likely to need to draw on reserves, as their 2002 budgets will be based on the lower costs they incurred in 2000 or 2001.

Vulnerability of Small PHAs to Increased Costs

Small PHAs and the families they serve are particularly vulnerable to a reduction in Section 8 reserves. About 1,800 of the 2,600 PHAs that administer the voucher program have fewer than 250 vouchers. Such small agencies have virtually no cushion in their regular annual budgets to accommodate a sharp cost increase, even for a few families. If an unusual number of large families come to the top of the waiting list or a few families move with their vouchers from inexpensive rural communities to more expensive cities or suburbs in search of work, an agency's average costs could substantially exceed its budget. In such cases, the PHA must rely on reserves to assist the authorized number of families.

Similarly, an agency may attempt to achieve full utilization of its voucher funds by overissuing vouchers, expecting that not all families will succeed in finding units. If more families than anticipated do succeed, however, a small PHA will not have the flexibility in its regular budget to meet its full obligations. It will need to draw on reserves to make payments to owners until some families leave the program through attrition.

The Merger of the Certificate and Voucher Programs May Affect Program Costs in 2002

In addition to the general factors that may affect a PHA's need to access reserves — such as rising costs or small agency size — reducing reserves may be particularly risky in 2002. That will be the first full year that the certificate and voucher programs will have been fully merged. (Conversion of families from the certificate program to the new voucher program will be completed in October 2001.) Conversion is likely to cause some increase in average costs, partly because subsidies were generally capped at the FMR in the certificate program but may exceed it in the voucher program, and partly because renewal funds in 2002 are based on a PHA's actual costs in 2000 or 2001, when most families were still under the certificate program. As a result, many PHAs may need to access reserves to continue providing assistance both to families previously on the Section 8 certificate program and to new families that receive vouchers that become available through turnover.

The Role of Reserves in PHA Decision-Making

An important subjective factor also must be considered in assessing the likely impact of the proposed halving of reserves. To avoid exhausting their budgeted resources, many PHAs would likely avoid increasing their average costs, such as by raising their voucher payment standards. This would be especially true if HUD were to return to the practice of making PHAs provide burdensome justification of the need to access reserves before granting permission.

If PHAs decline to increase payment standards, fewer units will fall within the price range accessible to families with vouchers, families may have less success in using their vouchers, and voucher holders may be further concentrated in poor neighborhoods. The net result may be that PHAs are unable to use all the funds appropriated for the voucher program, reducing the number of families receiving federally-assisted housing.

Predicting the Need for Reserves Based on Available Data

A comprehensive analysis of the potential problems that halving Section 8 program reserves may cause requires current data on reserve use as well as projections using current cost data. I hope HUD will make such data publicly available.

Data models developed for the 1999 negotiated rulemaking on the Section 8 renewal formula may, however, be instructive. HUD had consultants model the likely need for reserves under the renewal system ultimately adopted, as well as under other proposed methods. Based on actual costs in the mid-1990s, the model showed that approximately 15 percent of PHAs would need to use one month or more of their reserves in order to serve the authorized number of families during the period between incurring increased costs and receiving increased funding. Since average costs are likely to increase to an unusual extent in 2002 (due to the factors described above), this 15 percent figure probably understates the number of PHAs that may need to use a second month of reserve funds in 2002 to maintain program size.

The model also showed that PHAs experiencing “extreme variation” in costs, with average monthly costs changing from $460, to $650, to $690, to $500 over a four-year period, would need all two months of reserves in year 2 to maintain program size. In year 3 these PHAs would need additional funds on top of the two months of reserves (assuming HUD had replenished the reserve account) to provide assistance to the authorized number of families. Without additional funds, these PHAs would have to reduce program size by attrition or by terminating some families’ subsidies. If PHAs incur increased average costs but have only one month’s reserve available, they will be forced to reduce the number of families served more rapidly than under this model.

A Possible Compromise: A HUD Headquarters Reserve

There may be a compromise solution that would allow the one-time recapture of some Section 8 budget authority while ensuring that funds are available to those PHAs that need them. Instead of continuing to commit $640 million in budget authority to a second month of reserve funding for each PHA, some lesser amount could be placed in a HUD headquarters reserve. Funds from the headquarters reserve would be available to those agencies — probably less than half of all PHAs — that need more than one month’s reserve to provide voucher assistance to the number of families they are authorized to serve.

A headquarters reserve is authorized by the Section 8 voucher statute, which permits the HUD Secretary to set aside up to five percent of annual Section 8 budget authority as an "adjustment pool." The stated purpose of the set-aside is to permit PHAs to increase their voucher payments so that the change from a certificate to a voucher form of assistance does not require families to pay too much of their income for housing.[12] Nevertheless, the appropriations committees and the Congress have in the past directed that funds not obligated to PHAs be recaptured and rescinded.

In addition to stating clearly that HUD is permitted to hold a certain amount of appropriated funds in a headquarters reserve, it would be important for Congress to direct HUD to establish a simple and reliable method by which PHAs could obtain additional funds to serve the number of families authorized by HUD. As explained above, if PHAs do not trust HUD to make needed funds available, they are unlikely to incur additional costs in their voucher programs, and as a result problems with using vouchers are likely to increase.

Conclusion

A decade of prosperity has done little to alleviate America's housing needs. The recent reduction in the number of families with severe housing needs is good news, but the decrease in the number of affordable rental units on the private market has accelerated. Half of all renters — about one-sixth of the households in this country — have moderate or severe housing problems; 4.9 million very low-income households without housing assistance pay more than half of their income for housing or live in severely substandard housing. Relatively few of these households are likely to benefit from the Administration's proposed tax credit to reduce the costs of homeownership. The Administration's HUD budget request largely fails to respond to this need for affordable rental housing.

The Administration's request for 33,700 incremental vouchers is a positive step but one that does not go far enough in light of the magnitude of unmet needs. The requested increase is less than 40 percent of the 87,000 additional vouchers approved for fiscal year 2001 (79,000 "fair share" vouchers and 8,000 for the disabled). Further, the proposed reduction of 10,000 "tenant protection" vouchers compared with fiscal year 2001 may reflect a real decrease in the supply of federally assisted housing.

The proposed increase of $2.2 billion to renew expiring Section 8 contracts does not mean that any more households will receive federal housing assistance; it is merely the necessary means to transform multi-year obligations into annual funding. Furthermore, this $2.2 billion increase includes the offset of $640 million from PHA reserves for the voucher program, which

[12] See 42 U.S.C. § 1437f(o)(1)(C). Under the certificate program, families paid 30 percent of their income for rent and utilities. The PHA paid the remainder of the rental charge to the owner. Certificates could be used only in units that rented at or below the HUD-determined Fair Market Rent. Under the new merged voucher program, PHAs set a voucher payment standard between 90 and 110 percent of the FMR, with some exceptions. Families can choose to rent units with costs that exceed the PHA's payment standard (if the PHA determines that the rent is reasonable). If they rent more expensive units, they pay 30 percent of their income plus the rent in excess of the payment standard.

would be obtained by reducing PHA reserves from two months to one month and which may thereby require PHAs with significant cost increases to reduce the number of families they serve.

Rather than renewing all expiring Section 8 contracts as it purports to do, the Administration's budget thus may lead to a reduction in the number of families served by the voucher program. In addition, if the reduction in program reserves deters PHAs from increasing voucher payments when rents and utility costs increase, fewer families may be able to obtain housing with their vouchers and more voucher funds may remain unutilized.

In this era of budget surpluses, we can and should help provide more families with the decent, affordable housing they cannot obtain on the private market. A greater share of households with "worst case" housing needs than ever before are working, but their earnings are not sufficient to enable them to obtain decent housing they can afford. Lack of affordable housing may lessen the success of welfare reform by making it more difficult for families to obtain and retain employment. If we really want to "leave no child behind," as the President has urged, we should increase our investment in low-income housing substantially through production and rehabilitation of rental housing and additional housing vouchers.