CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1080 center@cbpp.org www.cbpp.org

Revised September 26, 2002

IS THE PROPOSED CUT TO THE PUBLIC HOUSING CAPITAL FUND JUSTIFIED?

by Will Fischer and Barbara Sard

The Bush Administration's budget for fiscal year 2003 would reduce the appropriation for the public housing capital fund to $2.43 billion from its fiscal year 2002 level of $2.84 billion. In his August 17, 2002 radio address, President Bush reiterated his support for reducing spending on the capital fund, which supports modernization and other capital improvements in public housing developments. The President cited the Senate Appropriations Committee's decision to provide $2.78 billion for the capital fund — $60 million less than last year — as an example of "ignoring fiscal discipline."

The Administration has provided two reasons for its proposed reduction. First, it points out that some funds appropriated to the capital fund in previous years remain unspent. Second, it asserts that a pilot initiative to allow public housing agencies to borrow private funds to finance capital improvements will generate enough resources in the coming fiscal year to make up for the funds lost due to the proposed budget cuts.

Neither of these points provides a convincing rationale for reducing capital fund appropriations. Estimates of current public housing modernization needs are sufficiently large that many years of funding even at the level approved by the Senate Appropriations Committee would be required to address the backlog of unmet needs. While some capital fund appropriations from previous years have not yet been spent, this seems to be largely a reflection of the extended periods required for completion of major capital projects and of the time consumed by the Department of Housing and Urban Development's (HUD's) process for distributing funds. Furthermore, the federal law that governs the capital fund already addresses the issue of unspent funds by placing limits on how long appropriations may remain unobligated and unspent. It appears that most public housing agencies (PHAs) comply with these limits, and the law provides mechanisms for penalizing those that do not.

Debt financing like that proposed in the Administration's pilot initiative may be a useful and appropriate tool for PHAs if it is accompanied by adequate protections to prevent loss of public housing units. But, regardless of its overall merits, it is highly uncertain that the Administration's debt financing proposal would generate sufficient resources to compensate for the proposed cuts during the first year of this proposal's implementation. HUD's budget justification states that the department will seek to restore the capital fund appropriation to its fiscal year 2002 level if the new initiative does not attract funds for at least $400 million in improvements during fiscal year 2003. It would be wiser, however, to maintain funding for pressing modernization needs at or close to the current level while this untried approach is tested.

Public Housing Modernization Needs are Very Large Compared to the Funding Available to Address Them

The most recent national study found a backlog of public housing modernization needs that is extremely large in comparison with the appropriations provided to address it. The study, conducted by Abt Associates, estimated that in 1998 public housing developments had capital needs totaling $24.6 billion.[1] A number of factors have led to this backlog, including the aging of public housing developments and historically inadequate funding levels for public housing maintenance and modernization.

Some of the 1998 modernization needs identified in the Abt Associates study have been met using the $14.5 billion in capital fund appropriations made during the period from 1998 through 2002. At the same time, however, new modernization needs have accumulated annually as housing projects have continued to age. The same study estimated that if all existing needs were met, projects would accumulate about $2 billion per year in additional modernization needs. If modernization costs have in fact accumulated at this rate, the total current backlog of needs would be slightly over $20 billion. This is consistent with estimates of $20 billion in current modernization needs cited by both the Administration and the Senate Appropriations Committee.[2]

These estimates should be used with caution. The rate at which new modernization needs accumulate is particularly difficult to project and may be substantially above or below $2 billion per year. PHAs are allowed to use some capital fund appropriations for operating expenses, so the full amount of capital fund expenditures does not necessarily go toward reducing the backlog. Finally, the composition of the public housing system may have changed during the period since the capital needs study was conducted, as some developments have been renovated or demolished through the HOPE VI program. The study of 1998 needs excluded units that were slated for demolition or transformation through HOPE VI at that time, but some additional HOPE VI projects have been funded since.

Regardless of the precise extent of capital needs, however, it is clear that the backlog is large enough that addressing it would require many years of funding at the level the Senate Appropriations Committee provided. Based on the rough numbers discussed above, more than 25 years of appropriations at that level would be needed to eliminate the current backlog and meet the new needs that would accrue over that period. Even including the Senate committee's HOPE VI appropriation, which may be used for a broad range of activities involving distressed public housing and therefore cannot be expected to reduce capital needs on a dollar for dollar basis, the backlog would not be eliminated for nearly 15 years. A more extended period would be required at the Administration's lower funding level, although the accompanying debt financing proposal may enable some improvements to be carried out earlier than would otherwise be the case.

Failing to fund modernization needs adequately is likely to cause units to be lost from the public housing stock. Between 1991 and 1999, the total number of public housing units fell by approximately 136,000.[3] In many cases, these units were lost because insufficient funds were available to rehabilitate them. The bi-partisan Millennial Housing Commission's 2002 report found that inadequate funding for operating and modernization costs has been the most significant impediment to preservation of public housing units.[4]

During the last three decades, the focus of federal low-income housing policy has shifted away from constructing new public housing projects toward housing vouchers, subsidies for privately-owned buildings, and tax credits for private production of new low-income housing. These shifting priorities, however, do not reduce the importance of ensuring that the nation's existing investment of over $90 billion in more than 1.2 million public housing units can continue to be used to meet the housing needs of low-income families. The urgency of public housing preservation and the size of the modernization backlog provide strong arguments that even if debt financing or other initiatives help to modernize public housing more quickly or efficiently, these gains should be used to increase the pace of modernization rather than as a rationale for cutting federal capital funding.

The Existence of Unexpended Public Housing Capital Funds Does Not Reduce the Need for New Appropriations

The Administration has maintained that the availability of unspent capital fund appropriations from previous years reduces the need for new funds in fiscal year 2003. The existence of unspent appropriations in the capital fund does not necessarily indicate, however, that new funds are not needed. By their nature, capital improvements often require substantial time for planning and implementation. In some cases, housing authorities must accumulate more than one year of funding from HUD before they are able to undertake a large modernization project. Furthermore, funds are not transferred by HUD to PHAs at the beginning of the fiscal year for which they are appropriated. In 2002, capital funds were distributed in July, ten months into the fiscal year.

The federal statute governing the public housing capital fund places time limits on expenditures that reflect these factors. With a few exceptions, PHAs have 24 months to obligate funds to specific projects and 48 months to spend the funds, with these timeframes running from either the date the funds were made available by HUD or the date that the agency accumulated enough funds to undertake a capital project. HUD has the power to penalize agencies that do not obligate and expend their funds according to these requirements, but it appears that most PHAs comply with the time limits. By 2002, for example, 2,981 of 3,071 agencies that received capital funds had obligated all of their fiscal year 1999 funds.[5]

The Administration's Debt Financing Proposal Does Not Justify Cutting Fiscal Year 2003 Appropriations

The Administration's budget included a proposal to enable PHAs to use debt financing to fund capital improvements. Under the proposal, labeled the Public Housing Reinvestment Initiative (PHRI), agencies could borrow money from private investors and pay back the loans over an extended period. The Administration proposal would allow $120 million from the capital fund and $130 million from the public housing operating fund to be used to support debt financing, including paying the first year of debt payments on loans and covering operating expenses. In later years, the federal government would distribute funds to pay for debt payments and operating costs through vouchers linked to the projects where improvements were carried out. One year after they receive these "project-based" vouchers, residents will have the option to receive "tenant-based" vouchers that they can use to move elsewhere. (A new family would then move into the unit to replace the one that left, and would receive project-based voucher assistance.)[6]

The Administration contends that the initiative would generate enough new resources to make up for the funds it proposes to cut from the public housing capital fund. HUD's budget justification indicates that PHRI is intended as a pilot initiative and that in fiscal year 2004, HUD will seek to restore funding to the previous year's level if the initiative does not generate at least $400 million in capital improvements. It is uncertain at this point whether the initiative will be approved by Congress. A provision implementing the debt-financing proposal was introduced as part of broad housing legislation in the House, but was later removed from the bill. The Senate Appropriations Committee did not include the proposal in the appropriations bill that covers HUD, and it is unclear whether the House Appropriations Committee will take any action related to PHRI.

The PHRI proposal is part of a recent trend toward allowing PHAs more authority to fund capital improvements through debt financing. Legislation passed in 1998 allowed PHAs to grant a security interest in their developments in order to obtain financing. Since that time, a small number of PHAs have used private investment to finance improvements. The Administration's proposal would make it easier to obtain financing on good terms by allowing long-term contracts and project-based financing.

Debt financing of public housing has the potential to deliver important benefits, but it also may carry serious risks. If PHAs are able to obtain large scale financing, the initiative would enable them to address the backlog in capital needs discussed above more rapidly than they currently can. Proponents of debt-financing assert that oversight by private lenders would also result in more efficient management of public housing. In addition, by giving public housing residents greater choice about where they will live, the Administration's proposal would offer them the opportunity to move closer to jobs and away from high-poverty neighborhoods.

At the same time, granting private lenders an interest in public housing developments creates a risk that affordable units could be lost through foreclosure. It is not clear that the Administration's proposal provides adequate safeguards against this risk. Regardless of the advantages or disadvantages of the proposal itself, however, it does not provide a persuasive rationale for cutting public housing capital funding in 2003.

It is Uncertain How Much Private Financing PHAs Would Be Able To Obtain, Especially During the Early Stages of Implementation

Facilitating debt financing of public housing modernization needs will only be able to produce an infusion of new resources if private lenders are willing to participate. An assessment of public housing capital lending by a bond rating agency suggests that this willingness generally would be high, but that it is dependent on lenders being provided relatively strong assurances that funding will be available in the future to repay loans.[7] Another analysis indicated that some form of credit enhancement, probably through mortgage insurance like that provided by the Federal Housing Administration (FHA), would most likely be needed to attract adequate private capital.[8]

The Administration's proposal includes many, though not all, of the assurances that lenders are likely to require. For example, while it does not propose long-term appropriations of the type that were employed in the Section 8 program in the 1970s and 1980s, the proposal would authorize long-term contracts like those that are currently used successfully in the Section 8 project-based voucher program. (These contracts are subject to annual appropriations, but Congress has never failed to renew existing Section 8 contracts.) The proposal does not provide FHA mortgage insurance, but it does allow PHAs to contribute funds to a loan loss reserve. It may be that the provisions of the Administration's proposal are sufficient to induce lenders to provide financing on terms that would be acceptable to PHAs, but this will not be known unless and until the initiative has actually been implemented.

Even if the structure of the initiative is adequate to attract lenders, however, it is very likely that there will be a period of transition before debt financing can be used to fund improvements on a large scale. HUD would need to develop the capacity to administer the program, which is very different from anything it has administered previously in the area of public housing. PHAs that had been accustomed to funding modernization with annual appropriations would need to develop more extensive improvement plans and build the expertise needed to seek private financing. Lenders would need to become familiar with the program and its potential. It is difficult to predict how much time these transitional processes would require.

In short, it is impossible to know at this time how much private financing the Administration's initiative would be able to attract or how rapidly that money would become available. It is unlikely that the proposal will generate the funds that would be needed to compensate for the proposed reductions in capital funding during fiscal year 2003.

Conclusion

Existing public housing projects help meet the housing needs of more than one million low-income households and are the product of more than 60 years of extensive public investment. Failure to address adequately the backlog of public housing capital needs jeopardizes this investment and threatens the well-being of the families and elderly and disabled individuals who depend on it. The Administration's debt-financing initiative may at some point be found to allow capital spending to be spread out over a longer period and annual appropriations to be reduced, but that time has not yet arrived.

To ensure that the backlog of capital needs continues to be addressed, it would be wise to maintain the appropriation for the public housing capital fund at least at the level of $2.78 billion approved by the Senate Appropriations Committee. It is important to emphasize that capital funding should not come at the expense of incremental Section 8 housing vouchers, which the

Administration proposed to fund at a somewhat higher level than the Senate Appropriations Committee provided.[9] Public Housing and Section 8 are the largest HUD programs targeted primarily to poor families and both should be priorities in shaping the HUD budget.

---

[1] Meryl Finkel et al, *Capital Needs of the Public Housing Stock in 1998*, prepared for U.S. Department of Housing and Urban Development, Abt Associates, January 2000.

[2] U.S. Department of Housing and Urban Development, 2003 Congressional Budget Justification, Public and Indian Housing: Public Housing Capital Fund; Senate Report 107-222, Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Bill, 2003.

[3] Millennial Housing Commission, *Meeting Our Nation's Housing Challenges*, May 30, 2002, p 100, citing Edgar O. Olsen, *Housing Programs for Low-Income Households*, National Bureau of Economic Research, April 2001.

[4] Millennial Housing Commission, 2002, p 20.

[5] National Association of Housing and Redevelopment Officials, "Public Housing Capital Fund Obligation," August, 2002.

[6] As with the existing project-based voucher program, PHAs would assign regular vouchers that become available as families leave the voucher program to tenants that wish to move; the funds committed to the former public housing units under the project-based voucher contract would remain committed to those units. See Barbara Sard, *Revision of the Project-Based Voucher Statute*, Center on Budget and Policy Priorities, April 2001 (available on web at http://www.cbpp.org/10-25-00hous.htm) for further information on project-based vouchers.

[7] Standard and Poor's Public Finance Division, *Public Housing Authority Capital Securitization Criteria*, July 19, 2001.

[8] Harvard Graduate School of Design, *Public Housing Operating Cost Study: Report on Debt Financing of Public Housing Capital Improvements*, prepared for U.S. Department of Housing and Urban Development, 2001, p 18.

[9] For discussion of incremental voucher funding, see Barbara Sard and Shayna Strom, *Funding New Welfare-to-Work Housing Vouchers Should Be a Priority for Fiscal Year 2003,* Center on Budget and Policy Priorities, September 2002 (available on web at http://www.cbpp.org/8-28-02hous.htm).