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March 25, 2011

CONVERTING FUNDING OF SOME PUBLIC HOUSING DEVELOPMENTS TO SECTION 8 SUBSIDIES WOULD HELP PRESERVE NEEDED UNITS

Steady Funding for Operating and Capital Subsidies Also Needed

By Will Fischer

The Obama Administration's 2012 budget proposes a demonstration project to fund a limited number of public housing developments through the "Section 8" rental assistance program rather than the public housing program. These conversions should help preserve the nation's stock of public housing by giving local agencies more adequate and reliable subsidies and greater access to private loans to finance needed renovations. This approach may offer the most realistic way to preserve public housing developments as affordable housing for the long run, and a demonstration would offer a low-cost means to test and refine it.

Congress should also provide steady funding for the public housing operating and capital funds and take other measures to preserve and revitalize public housing. Unless these steps are accompanied by conversion of at least some developments to Section 8, however, they are unlikely to provide sufficient resources to address the backlog of unmet public housing renovation needs, estimated to exceed $20 billion. Failure to meet those needs is likely to result in higher future federal costs and have adverse consequences for the more than 1.1 million vulnerable households that live in public housing — the great majority of which consist of elderly people, people with disabilities, or working-poor families with children.

Added Resources Needed to Preserve Public Housing — But Sufficient Up-Front Public Funds Are Unlikely to Materialize

Most public housing units are in decent condition, but due to the age of the properties and long-term underfunding, developments have accumulated a large backlog of unmet renovation needs. Leaving public housing repair needs unmet will raise future federal costs by deferring improvements that would prevent more costly damage down the road (such as structural deterioration caused by a leaky roof) or reduce energy consumption and costs. For example, the federal government spends more than $2 billion a year on utility subsidies for public housing residents; efficiency measures such as installing new windows could reduce this amount considerably.

Failure to address renovation needs would also cause living conditions to deteriorate for families in public housing and risk blight that would lower property values in surrounding neighborhoods.

Without sufficient funds to renovate and preserve public housing, many developments could deteriorate to the point where they would have to be demolished or sold. From 1995 to 2008, more than 165,000 public housing units were lost and not replaced by new public housing. Tens of thousands of additional units have been removed from the stock since then.

Some lost public housing units — 50 to 60 percent, according to the Congressional Budget Office (CBO)[1] — are replaced with "tenant-based" Section 8 vouchers, which families use to help defray the cost of renting a unit of their choice in the private market. Such vouchers are a highly effective form of housing assistance, but it would be harmful to indiscriminately allow public housing to be lost and replaced by tenant-based vouchers, for several reasons. First, it will sometimes be more cost effective to preserve existing public housing in which the federal government and state and local agencies have already made substantial investments. Second, mobility limitations and other factors can make it difficult for many elderly people, people with disabilities, and others to use vouchers. Finally, some public housing developments are located in neighborhoods with strong schools and good access to jobs and transportation, but where it would be difficult for a low-income family to find affordable housing to rent with a voucher.

Moreover, many lost public housing units are not replaced with any form of housing subsidy, adding to the already large unmet need for housing assistance. Fewer than one in four eligible low-income families receive housing assistance today, and many parts of the country have long waiting lists for assistance. A recent HUD report found that in 2009, some 7.1 million very low-income renter households had what HUD terms "worst-case housing needs," meaning that they paid more than half their income in rent or lived in severely substandard housing.[2] Families with high housing costs who do not receive housing assistance are much more likely to experience homelessness, overcrowding, and frequent moves from apartment to apartment — conditions which have been found to have harmful effects on children's academic performance and mental and physical health.

The most immediate measures Congress can take to preserve public housing would be to avoid cuts to the Public Housing Operating Fund (which covers the gap between the rents that low-income residents can afford and the day-to-day costs of operating public housing) and the Public Housing Capital Fund (which pays for major renovations and repairs to public housing). The 2011 funding proposals Congress is considering appear to fully fund the subsidies that agencies are due

[1] Congressional Budget Office, *Cost Estimate: H.R. 5814, Public Housing Reinvestment and Tenant Protection Act,* October 28, 2010.

[2] Barry L. Steffen *et al., Worst Case Housing Needs, 2009: A Report to Congress*, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, February 2011.

under the operating fund.[3] But the funding bill the House passed on February 19 (H.R. 1) would cut the capital fund by $1.1 billion, or 43 percent.[4]

A cut this large could result in rapid deterioration in living conditions and a sharp acceleration in the loss of public housing units. It will be important for Congress to maintain capital funding at no lower than the $2.5 billion provided in 2010.[5]

That amount would come close to covering the new capital needs estimated to accumulate in public housing each year but would provide no funds to address the backlog of existing needs. Moreover, given the threat of cuts and the grim overall budget environment, it is extremely unlikely that in the foreseeable future, Congress will increase capital funding enough to address the backlog. As a result, other measures will be needed to preserve and modernize public housing. The most promising such approach to preserving public housing is conversion of some developments to "Section 8" rental subsidies, as explained below.

Proposed Section 8 Conversions Would Help Preserve Developments

The Obama Administration's 2012 budget proposes a "Transforming Rental Assistance (TRA)" demonstration that HUD estimates would convert 255,000 public housing units to Section 8 subsidies at a cost of $170 million.[6] The converted units would have "project-based" subsidies attached to them; these are subsidies tied to a specific development rather than being used in a modest unit of a family's choice, like "tenant-based" vouchers. The subsidies would be similar to those provided under two existing programs — Section 8 Project-Based Rental Assistance (PBRA)

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3 In 2012, the Administration's budget proposes to deduct $1 billion from the operating subsidies due to agencies with "excess" operating fund reserves. Such reserves play an important role in enabling agencies to responsibly manage developments, however, and the Administration has not indicated how it would distinguish needed reserves from excess reserves. It may be possible to deduct some funding at agencies with extremely high reserve balances without serious adverse consequences. But the amount that can be responsibly deducted is likely to be well below $1 billion, in which case the 2012 appropriation will need to substantially exceed the Administration's $3.96 billion request.

4 For more information on the housing provisions of the House funding bill, see Douglas Rice, "House Spending Bill Renews Most Low-Income Rental Assistance But Would Undercut Efforts to Reduce Homelessness and Meet Other Critical Housing Needs," Center on Budget and Policy Priorities, March 7, 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3420.

5 Public housing and many other government programs are currently funded through a temporary continuing resolution that runs through April 8. Under that resolution, both the operating and capital funds are funded at the same level as in 2010.

6 The budget also requests $30 million to fund the conversion to long-term project-based Section 8 subsidies of 7,600 privately owned units that currently receive subsidies through three small HUD programs, for a total TRA request of $200 million. These 7,600 units include 1,600 units from the Rental Assistance Program (RAP) and Rent Supplement program, and 6,000 units from the Section 8 Moderate Rehabilitation program. These three programs are similar to the Section 8 Project-Based Rental Assistance (PBRA) program but are subject to some distinct rules and (unlike PBRA) currently provide no adequate mechanism to preserve developments as affordable housing when their existing subsidy contracts expire.

By authorizing and funding the conversion of these units to long-term project-based Section 8 contracts, Congress would prevent their loss as affordable housing. This action would not need to be part of the same initiative that preserves public housing, and broad conversions should *not* be delayed while a demonstration is conducted. These programs are small, the subsidy contracts for many of these units are due to expire before the results from a demonstration would be available, and Congress has permitted conversions from these programs to PBRA in the past.

and the project-based component of the Section 8 voucher program — with some changes in program rules.

These conversions would not require any change in ownership; the local housing agency could continue to own and manage a converted development and would receive the Section 8 subsidies from HUD in place of the public housing subsidies it receives for the development today. Such conversions would support public housing preservation in two main ways:

- **More adequate and reliable subsidies.** Conversions would modestly increase subsidies for the affected public housing developments — an added $669 per unit annually on average, according to HUD. Today, the amount that housing agencies receive in federal subsidies and tenant rent payments is less than they need to sustain a development (and also usually less than local market rents for comparable units). By contrast, the Section 8 subsidy levels for developments converted under the demonstration would take sustainable funding levels and market rents into consideration and would thus be somewhat higher.

  The new subsidies also would likely maintain their value over time, since Congress has generally provided adequate funding to cover subsidies under the PBRA and voucher programs. By contrast, public housing subsidies have often experienced sharp cuts and shortfalls. In seven of the last eight years, Congress has provided less funding for the public housing operating fund than was needed to cover the operating subsidies that local agencies were due under the program's basic formula, with the shortfalls exceeding 10 percent in five of those years. Since 2001, inflation-adjusted funding for the capital fund has dropped by 33 percent.

- **Greater access to private financing to help meet renovation needs.** Conversion of public housing units to Section 8 subsidies would allow agencies to borrow private funds more easily, in part because the greater reliability of the funding would give lenders added confidence that the loans would be paid back, allowing agencies to obtain better loan terms. Section 8 program rules also would give local housing agencies greater flexibility than current public housing rules to mortgage a development, which would further increase the amount of funds they can borrow from private lenders to support renovation.

Revisions Needed to Expand Housing Choice and Protect Tenants

To maximize the benefits of converting some public housing developments to Section 8 subsidies, the conversions should ensure that the affected developments: (a) give families greater choice about where they live, (b) are maintained as affordable housing for the long run, and (c) protect key rights of residents. The Obama Administration has expressed support for these goals, but the legislative language in its budget does not require that conversions be carried out in a manner that advances them. Congress can address those problems by adding strong requirements as part of the authority for the demonstration.[7]

- **Expanding housing choice.** Residents of converted developments should have the option to

[7] Representative Keith Ellison introduced legislation in December 2010 that was based on the TRA proposal in HUD's 2011 budget but contained stronger provisions protecting long-term affordability and tenant rights. We recommend that, in general, a TRA demonstration establish protections in these areas similar to those in the Ellison bill.

move with a tenant-based voucher after a period of time; a family that has been on the waiting list for assistance would then move into the vacated project-based unit. This option to move is already available to tenants in project-based voucher developments (who are permitted to relocate after one year), but not to residents of public housing or developments subsidized through PBRA or other programs.

Permitting families to choose whether to stay in project-based housing or use their subsidy to move elsewhere enables them to better match the location of their homes to the circumstances of their lives. It can, for example, allow a laid-off worker to relocate to pursue a job opportunity, a family with children to move near a grandparent who can provide child care, or an elderly person or person with a disability to move near a medical facility that provides a particular type of care — all without losing their subsidy.

The option to move also would impose a measure of discipline on a development's management. If a development is so unsafe or badly maintained that many tenants move out after brief stays, management would face higher costs (to prepare units for new tenants and process paperwork related to turnover) and perhaps lower rent revenue (since project-based assistance payments cannot be made for a unit that has been vacant for more than 60 days, and it may be difficult to fill units in that time). HUD could also use the rate at which tenants choose to leave project-based developments to identify developments where conditions may be deteriorating and additional oversight may be needed.

- **Long-term affordability.** Mortgaging developments (which, as noted, would be easier for units that had been converted to Section 8 subsidies) could pose new risks for the long-term preservation of public housing: in theory, lenders could foreclose on developments if payments are not received and seek to raise rents and end key protections for tenants. Conversions thus need to be subject to strong protections to minimize these risks. In the event that a private lender forecloses on a development, HUD should be required to purchase the development for a fair price (determined through a non-biased appraisal process) and resell it to another public or non-profit entity, and the foreclosing lender should be required to accept HUD's offer.[8] In addition, if a property is foreclosed upon or transferred to a new owner for other reasons, the owner should be required to continue to accept Section 8 subsidies, and the accompanying federal rules that limit rental charges for low-income tenants to a percentage of tenants' incomes, along with other tenant rights, should remain in place.

- **Procedural and organizing rights.** Conversions also raise the risk that tenants will lose rights in areas where public housing provides better protections than the PBRA or voucher programs. These include the ability to form resident organizations that provide input into building management and robust grievance procedures that allow residents to challenge unfair agency decisions. Legislation should require that these and other key rights be retained after conversion.

[8] Mortgages for converted properties also could be insured through the Federal Housing Administration (FHA). If an agency defaulted on an FHA-insured mortgage, FHA would pay the insured balance of the loan, take over the lender's rights to the property, and transfer or sell the property to a new owner (in which case the Section 8 subsidies and accompanying tenant protections should be required to remain in place, as with any transfer of ownership).

Demonstration Would Have Modest Costs and Allow Testing of Key Policies

Housing agencies can convert public housing developments to project-based vouchers today, but federal law and HUD administrative policies limit the number of developments that can be converted and do not require the protections for long-term affordability and tenant rights noted above. As a result, Section 8 conversions cannot be used effectively to preserve a sizable share of the public housing stock without congressional approval.

The Administration's proposal to launch a demonstration in 2012 differs from the TRA proposal in its 2011 budget, which called for legislation to permanently authorize conversions and framed the initial conversions as the first phase of a process that would eventually reach the bulk of the subsidized housing stock. The proposed demonstration differs from the earlier proposal in several key respects:

- The funding commitment would be more modest, since a demonstration would not imply that additional developments would be converted in later years.[9]

- A demonstration would allow policies to be tested before a decision is made whether to implement them on a larger scale.

In fact, to conduct an effective demonstration, it would not be necessary to convert 255,000 public housing units, as the Administration has proposed. HUD could test a variety of conversion approaches in a range of development types with a demonstration involving many fewer units.[10]

Other Preservation Measures Are Needed But Would Not Be Sufficient

If Section 8 conversions prove successful, they will not be the only measure needed to preserve public housing. Additional capital resources will be needed to preserve some developments that are important to preserve but where the amount that could be borrowed using Section 8 subsidies would not be adequate to meet renovation or replacement needs. In addition, broader neighborhood investments and social services will be necessary to improve living environments at some developments located in high-poverty neighborhoods. Certain restrictions on demolition and disposition of public housing also have a role to play in averting the loss of the most valuable public housing. These types of provisions, however, are likely to be insufficient to address public housing capital needs, unless they are accompanied by the type of adequate, reliable subsidies and improved

[9] The modestly higher subsidies at converted developments would need to be maintained after 2012, but there would be no major added cost increases unless Congress later decided to permit conversions on a broader scale.

[10] A smaller demonstration could reduce the cost of public housing conversions below the Administration's $170 million request, but this would not be assured because the Administration's estimate of the added subsidy needed per unit could turn out to be too low. Since the added subsidy reflects the gap between the amount provided by the public housing operating and capital subsidy and the amount provided by a Section 8 subsidy, any change to public housing funding levels would affect the amount of subsidy needed. For example, if the House Republican proposal to cut the public housing capital fund by $1.1 billion were enacted in 2011 and maintained in 2012, this would substantially increase the incremental funding needed for Section 8 conversions.

access to debt financing that Section 8 conversions should provide.[11]

Other types of preservation measures, which would be helpful but almost certainly would be insufficient by themselves, include the following.

Low-Income Housing Tax Credits

The Low-Income Housing Tax Credit (LIHTC), the largest federal program supporting rehabilitation and construction of affordable housing, can provide an important resource to support rehabilitation of public housing. However, the amount of LIHTCs is limited, and states allocate most of the credits to construction and rehabilitation of housing *other than* public housing.

The Administration's 2012 budget proposes to increase the amount of the credit for a small number of developments that use one type of LIHTC (the "4 percent" credit) to preserve existing federally subsidized housing. This would provide a modest but helpful boost for public housing preservation. Because the amount of resources is small, Congress should require that such an increase be targeted on developments (like public housing) that assist the lowest-income families, rather than developments that serve families who have somewhat higher incomes and consequently less need for affordable housing. In addition, Congress should consider expanding the Administration initiative so that more public and other subsidized housing developments can receive added LIHTCs. Even with the proposed boost, however, the credit would only cover a portion of rehabilitation costs, and housing agencies would generally need to use it in combination with other financing, such as the loans they could obtain using Section 8 conversions under the proposed demonstration.

Grants to Revitalize Severely Distressed Public Housing

Since 1993, Congress has funded grants through the HOPE VI program to demolish and replace the most distressed public housing developments. In 2009, the Obama Administration proposed to replace HOPE VI with the Choice Neighborhoods Initiative (CNI), which would continue to provide revitalization grants but make various improvements on HOPE VI. For example, CNI would require that all units demolished as part of revitalization efforts be replaced with some form of housing assistance; it would also encourage supportive services for residents of revitalized developments and efforts to help displaced families move to high-opportunity neighborhoods. In addition, the Administration proposed to coordinate CNI grants with programs administered by other agencies — such as the Department of Education's Promise Neighborhoods program — to support broader efforts to improve conditions in high-poverty neighborhoods.

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[11] One measure that some proponents have claimed would preserve public housing is an expansion of the Moving-to-Work (MTW) demonstration, which permits HUD to provide a limited number of housing agencies broad waivers of federal statutes and regulations and the flexibility to use public housing and voucher funds for purposes that are not normally permitted. Some agencies have used flexibility under MTW to renovate or replace public housing, but they have done so in large part by leaving some housing vouchers unused and shifting voucher funds into their public housing programs. These shifts reduce the overall number of families assisted and consequently leave many vulnerable families on waiting lists who could have been helped with available funds. As a result, MTW expansion is not a desirable strategy for preserving public housing. For additional information on MTW, see Will Fischer, "Sharp Expansion of HUD's Moving-to-Work Demonstration Raises Serious Concerns," Center on Budget and Policy Priorities, January 22, 2009, http://www.cbpp.org/cms/index.cfm?fa=view&id=3055.

Congress provided $65 million for a small-scale CNI demonstration in 2010, but also provided $135 million to continue HOPE VI. The Public Housing Reinvestment and Tenant Protection Act, which the House Financial Services Committee passed in July 2010 and Representative Maxine Waters (D-LA) recently reintroduced, would authorize CNI on an ongoing basis. Senator Robert Menendez (D-NJ) has introduced CNI authorization legislation in the Senate.

Authorizing and continuing to fund CNI would strengthen federal efforts to revitalize distressed public housing. But it likely would affect only a small segment of the public housing stock. HUD estimates the total HOPE VI and CNI funding in 2010 will be adequate to fund revitalization of just *seven to ten developments*. It also appears unlikely in the near term that authorization of CNI will result in a significant expansion in the amount of resources available to revitalize distressed public housing: the 2011 appropriations bill the House passed on February 19 not only provided no new CNI or HOPE VI funding but also rescinded the funds provided for both programs in 2010.

Capital Fund Financing Program

Housing agencies today can take out loans from private lenders and pledge their future public housing capital grants as collateral, an option labeled the Capital Fund Financing Program (CFFP).[12] CFFP has helped rehabilitate a significant number of developments, and the option will continue to play an important role for public housing (other than housing that is converted to Section 8 funding).

But CFFP and other borrowing that is primarily backed by future subsidies, without the additional security provided by a mortgage on a development, will generate much less investment by lenders than could be obtained through Section 8 conversions and mortgage financing. HUD estimates that the $170 million requested for TRA public housing conversions (in combination with the operating and capital funds allocated to the converted developments) would allow agencies to borrow approximately $6.1 billion. Under CFFP, agencies would need about *$1.2 billion* in added capital grants to borrow that same $6.1 billion.

The Public Housing Reinvestment and Tenant Protection Act (PHRTPA) would seek to enhance the CFFP option by authorizing HUD from 2012 to 2014 to guarantee $500 million per year in loans to local housing agencies from private lenders, backed by public housing capital funds. Such guarantees could improve the terms on which agencies can obtain loans, reducing interest rates and modestly increasing the amount that agencies can borrow.[13]

But the guarantees are unlikely to expand substantially the resources for public housing because of the manner in which they are treated under federal budget rules. When Congress provides authority for loan guarantees, it appropriates funds to cover the expected cost of those guarantees based on

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[12] Federal law also authorizes an Operating Fund Financing Program (OFFP) in which agencies can obtain loans and pledge operating subsidies as repayment. HUD has not issued final regulations implementing the OFFP, however, and only a small number of transactions have been carried out.

[13] Agencies are currently prohibited from pledging more than 33 percent of their capital fund appropriations for loan repayment, with limited exceptions. Even if this prohibition were lifted, many lenders would hesitate to make loans that require an agency to use a larger share of its funds for payments, out of concern that capital funds would be cut in the future. A guarantee, however, would encourage lenders to make somewhat larger loans because there would be a firm guarantee that the federal government would pay the loans back.

the probability that the loan will be repaid and other factors. In estimating the cost of the guarantees, however, CBO assumes no federal appropriations beyond those already enacted into law — and since capital fund appropriations are approved one year at a time, CBO assumes that no funds will be available to pay the loans back and that every dollar of the guarantee will be needed to repay lenders. As a result, $500 million in loan guarantees would require the same appropriation level in the year the guarantees are issued as $500 million in *grants,* even though the benefit provided by guaranteeing a CFFP loan would be far less than the benefit of a grant (because substantial payments would be required in later years to repay the guaranteed loan).

Restrictions on Demolition and Sale of Public Housing

PHRTPA also would prohibit demolition or sale of public housing unless the units are replaced on a one-for-one basis with "hard" housing units that have project-based subsidies attached to them, with limited exceptions. This provision would slow the demolition and sale of public housing developments. It could, however, result in some adverse consequences unless Congress provides adequate resources to renovate or replace developments (for example, by scaling up the proposed conversion demonstration if it proves successful). Living conditions for residents could deteriorate, and many units could become uninhabitable and be left vacant, with the result that affordable housing stock would be lost anyway. The public housing program operated under a one-for-one replacement requirement prior to 1995; the elimination of that requirement led to the loss of many developments, and developments were demolished or sold without being fully replaced with new "hard" units. At the same time, elimination of the requirement also played a part in significant improvements to the quality of the public housing stock that occurred over the following decade, because housing agencies were able to demolish and partially replace severely distressed developments when they did not have adequate resources for full replacement.

Even if adequate funds are available to build new units or comprehensively renovate existing ones, maintaining the current number of hard units will not always be the best use of scarce resources. In some areas, tenant-based vouchers can provide benefits that are as good as or better than those provided by hard units, at lower cost. In these areas, it would be beneficial to allow housing agencies to replace public housing at least in part with tenant-based vouchers. PHRTPA would permit replacement with tenant-based vouchers in some areas where those vouchers can be used readily, but only for 10 percent of an agency's total number of public housing units over a period of ten years.

Conclusion

Unless Congress takes strong action to support public housing in the coming years, there is a serious risk that losses of needed developments will accelerate. Most immediately, Congress should reject harsh cuts to public housing subsidies and provide full operating subsidies and capital funding at no lower than the 2010 level.

But steady funding for the existing subsidy structure will not be sufficient, since recent efforts to cut funding make clear that the chances are extremely remote that Congress will *increase* capital fund appropriations enough to address the capital backlog, now estimated at more than $20 billion.

Other options, including those contained in PHRTPA, on their own would have only a limited impact on the backlog.

The most promising alternative is conversion of some public housing units to project-based Section 8 subsidies. It would be highly beneficial for Congress to include authority and funding for a modest conversion demonstration in 2012 appropriations legislation, so that the approach can be scaled up promptly if it proves effective.