Housing and Community Development Needs:
The FY 2003 HUD Budget

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Mister Chairman, Senator Gramm, and members of the Committee on Banking, Housing, and Urban Affairs: I welcome this opportunity to talk with you about the FY2003 HUD Budget. I speak from the perspective of a taxpayer who wants to help low-income families. I have no other financial interests in the matters under consideration at this hearing.

My views are influenced not only by this perspective but also by my knowledge of the systematic evidence about the effects of low-income housing programs. I have been involved in housing policy analysis since the late 1960s. Since then, I have done many empirical studies of the effects of low-income housing programs, and I have read carefully a very large number of other studies. During the Nixon Administration, I was an analyst on the Housing Policy Review Task Force that led to the Section 8 Certificate Program. As a visiting scholar at HUD during the Carter Administration, I worked on an evaluation of this program and reviewed the final reports from the Experimental Housing Allowance Program. More recently, I have written a lengthy survey of what is known about the effects of low-income housing programs for a National Bureau of Economic Research volume on means-tested transfer programs, and I did a substantial amount of work as a consultant to the GAO on their study comparing the cost-effectiveness of

tenant-based vouchers and major construction programs such as the Low Income Housing Tax Credit and HOPE VI. My testimony will focus on the HUD budget for low-income housing programs.

Given the current economic slowdown and the added expense of fighting international terrorism, it is clear that little additional money will be available for housing assistance over the next few years. The question is: How can we continue to serve current recipients equally well and serve some of the poorest families who have not yet been offered assistance without spending more money? The answer is that we must use the money available more wisely.

Research on the effects of housing programs provides clear guidance on this matter. It shows that we can serve current recipients equally well (that is, provide them with equally good housing for the same rent) and serve many additional families without any increase in the budget by shifting resources from project-based to tenant-based assistance.

Five major studies have estimated both the cost per unit and the mean market rent of apartments provided by housing certificates and vouchers and the largest older production programs, namely Public Housing, Section 236, and Section 8 New Construction.[1] These studies are based on data from a wide variety of housing markets and for projects built in many different years. Three were multi-million dollar studies conducted for HUD by respected research firms during the Nixon, Ford, Carter, and Reagan administrations. They are unanimous in finding that housing certificates and

[1] The studies are Mayo and others (1980), Olsen and Barton (1983), Schnare and others (1982), U.S. Department of Housing and Urban Development (1974), and Wallace and others (1981). Olsen (2000) provides a description and critical appraisal of the data and methods used in these studies as well as a summary of their results.

vouchers provide equally desirable housing at a much lower total cost than any of these production programs, even though all of these studies are biased in favor of the production programs to some extent by the omission of certain indirect costs.

The studies with the most detailed information about the characteristics of the housing provided by the programs found the largest excess costs for the production programs. One study estimated the excessive cost of public housing compared to housing vouchers for providing equally desirable housing to be 64% and 91% in the two cities studied and the excessive cost of Section 236 to be 35% and 75% in these two cities (Mayo and others, 1980). Another study estimated the excessive cost of Section 8 New Construction compared to tenant-based Section 8 Certificates to be 37% even when *all* of the indirect costs of the Section 8 New Construction program are ignored (Wallace and others, 1981). These indirect subsidies include GNMA Tandem Plan interest subsidies for FHA insured projects and the forgone tax revenue due to the tax-exempt status of interest on the bonds used to finance SHFA projects. Based on previous studies, the authors argue that these indirect costs would add 20 to 30 percent to the total cost of the Section 8 New Construction Program.

The recently completed GAO study produced similar results for the major active construction programs – LIHTC, HOPE VI, Section 202, Section 515, and Section 811. Using the conceptually preferable life cycle approach, the excess total cost estimates range from at least 12% for Section 811 to at least 27% for HOPE VI.[2] (The GAO

[2] The GAO study also reports first-year excess costs of the production programs. The first-year cost of a production program is the sum of the annualized development subsidies and the tenant rent and other government subsidies during the first year of operation. The estimates of excess cost of production programs based on this method are much higher than estimates based on the life-cycle approach. Although these estimates may be closer to the truth due to the omission of some of the costs of production programs and deviations between the assumptions of the life-cycle analysis and reality, this methodology is defective for the reasons explained in Olsen (2000, pp. 18-21).

calculations exclude HOPE VI construction costs that are not related to housing.) These estimates are lower bounds on the excessive cost because some costs of the production programs were omitted due to the difficulty of collecting the relevant data. For example, all public housing projects receive substantial local property tax abatements. The GAO analysis ignores this cost to local taxpayers. An earlier study (reported in Olsen, 2000, p. 16) estimated that these abatements account for 22 percent of the cost of this program to taxpayers.

The GAO study also contains evidence concerning whether production programs are more cost-effective than tenant-based vouchers in the tightest housing markets. In addition to the national estimates, the GAO collected data for seven metropolitan areas. The data for the GAO study refer to projects built in 1999. In that year, the rental vacancy rates in the seven metropolitan areas ranged from 3.1% in Boston to 7.2% in Baltimore and Dallas, with a median of 5.6%. The overall rental vacancy rate in U.S. metropolitan areas was 7.8%. So all of the specific markets studied were tighter than average. Only five of the largest seventy five metropolitan areas had vacancy rates lower than Boston's.. In each market, tenant-based vouchers were more cost-effective than each production program studied.

The GAO study will not be the last word on the cost-effectiveness of the programs studied. Improvements in its implementation of the life-cycle methodology are possible and desirable. However, it provides the only independent cost-effectiveness analysis of these programs.

The magnitude of the gain from shifting from project-based to tenant-based assistance would be substantial. Even the smallest estimates of the excess costs of

project-based assistance imply that shifting ten families from project-based to tenant-based assistance would enable us to serve two additional families. Since HUD provides project-based assistance to more than three million families, a total shift from project-based to tenant-based assistance would enable us to serve at least 600,000 additional families with no additional budget. The most reliable estimates in the literature imply much larger increases in the number of families served. For example, the Abt study of the Section 8 New Construction Program implies that tenant-based vouchers could have provided all of the families who participated in this program with equally good housing for the same rent and served at least 65 percent more families with similar characteristics equally well without any additional budget. Since this program served over 900,000 families at its peak, this amounts to an additional 585,000 families.

These findings have important implications for how the HUD budget should be spent.

First, the money currently spent on operating and modernization subsidies for public housing projects should be used to provide tenant-based vouchers to public housing tenants, as proposed by the Clinton Administration and by Senator Dole during his presidential campaign. To enable housing authorities to provide decent housing despite this loss in revenue, they should be allowed to rent their apartments to any household eligible for housing assistance for whatever rent this market will bear. Families with tenant-based vouchers would occupy many of these apartments. Other families eligible for housing assistance would occupy the rest. Housing authorities could raise additional money by taking advantage of the current regulation that allows them to sell projects. At present, they have little incentive to do it. Without guaranteed federal

operating and modernization subsidies, many authorities may well decide to sell their worst projects. These are the projects that will be abandoned to the greatest extent by their tenants with vouchers, and they are the most expensive to operate. They should be sold in their current condition to the highest bidder in order to maximize the revenue available to modernize other projects. If housing authorities are unable to compete with private owners for their tenants, they should not be in the business of providing housing.

Second, contracts with the owners of private subsidized projects should not be renewed. Instead we should give their tenants portable vouchers and force the owners to compete for their business. Tenants who choose to move should be given a modest grant for moving expenses. This is far less expensive than continuing with these costly forms of project-based assistance.[3] It is important to realize that for-profit sponsors will not agree to extend the use agreement unless this provides at least as much profit as operating in the unsubsidized market. Since these subsidies are provided to selected private suppliers, the market mechanism does not insure that profits under the new use agreement will be driven down to market levels. If this is to be achieved at all, administrative mechanisms must be used. Proponents of all previous programs of this sort argued vigorously that their program would insure that excessive costs were not paid for apartments. Cost-effectiveness studies of these programs indicate that they failed badly to control costs. There is no reason to believe that the Mark-to-Market initiative will produce better results. It will merely hide the excess cost to a greater extent. We should leave the job of getting value for the money spent to the people who have the greatest incentive to do it, namely the tenants.

[3] See Weicher (1997) for a detailed analysis of vouchering out project-based assistance.

Third, the construction of additional public or private projects should not be subsidized. For example, no additional money should be allocated to HOPE VI. This program is an improvement over traditional public housing in that it avoids concentrating the poorest families at high densities in projects. However, the GAO study reveals that it is highly cost-ineffective compared with tenant-based vouchers that also avoid these concentrations. For the same reason, there should be no new HUD production program.

Most people who develop and operate subsidized housing projects will oppose these reforms. However, they will give taxpayers who want to help low-income families more for their money by greatly increasing the number of families served without spending more money or reducing support for current recipients.

Two main objections have been raised to exclusive reliance on tenant-based assistance. Specifically, it has been argued that tenant-based assistance will not work in markets with the lowest vacancy rates and construction programs have an advantage compared with tenant-based assistance that offsets their cost-ineffectiveness, namely they promote neighborhood revitalization to a much greater extent.

Taken literally, the first argument is clearly incorrect in that Section 8 Certificates and Vouchers have been used continuously in all housing markets for more than two decades. A more precise version of this argument is that tenant-based assistance will not work in the some markets because these markets do not have enough vacant apartments that meet minimum housing standards and are affordable to voucher recipients. The defects of this argument are easy to understand, and it is inconsistent with the empirical evidence.

All vouchers authorized in a locality can be used even if the number of vacant apartments that meet minimum housing standards and are affordable to voucher recipients is less than the number of vouchers authorized. Some recipients offered vouchers might already occupy apartments meeting the program's standards. In this case, the family can participate without moving. In the absence of assistance, these recipients typically devote a high fraction of their income to housing and skimp on other necessities. The housing voucher reduces their rent burden. Other families who are offered vouchers will live in housing that does not meet Section 8 standards. However, these apartments can be repaired to meet the standards. Similarly, vacant apartments that do not initially meet the program's standards can be upgraded to meet them. In short, we do not need new construction to increase the supply of apartments meeting minimum housing standards.

The evidence shows that these are not theoretical curiosities. The tenant-based Section 8 Certificate and Voucher Programs have substantially increased the supply of affordable housing meeting minimum housing standards. The most recent detailed analysis is based on data from a national random sample of 33 public housing authorities in 1993 (Kennedy and Finkel, 1994). Thirty percent of all recipients outside of New York City continued to live in the apartments that they occupied prior to participating in the program (Kennedy and Finkel, p.15).[4] Forty one percent of these apartments already met the program's standards and 59% were repaired to meet the standards (Kennedy and Finkel, p.83). About 70% of all recipients outside of New York City moved to a new unit. About 48% of these apartments were repaired to meet the program's standards (Kennedy and Finkel, p.84). The rest moved to vacant apartments that already met the

[4] The authors analyzed New York City separately from the other housing authorities.

standards. Therefore, the apartments occupied by about half of the families that received certificates and vouchers outside NYC during this period were repaired to meet the program's standards. The previously mentioned sources contain similar results for NYC. In this city, only 31 percent of the apartments occupied by recipients had to be repaired to meet the program's standards.

The Housing Assistance Supply Experiment of the Experimental Housing Allowance Program (EHAP) provides even more powerful evidence on the ability of tenant-based vouchers to increase the supply of apartments meeting minimum housing standards even in tight housing markets. The Supply Experiment involved operating an entitlement housing allowance program for ten years in St. Joseph County, Indiana (which contains South Bend) and Brown County, Wisconsin (which contains Green Bay). These were smaller than average metropolitan areas with populations of about 235,000 and 175,000 people, respectively. The general structure of the housing allowance program in the Supply Experiment was the same as the Section 8 Voucher Program that HUD operated from 1983 until its merger with the new Housing Choice Voucher Program, except that homeowners were eligible to participate in the Supply Experiment. About 20 percent of the families in the two counties were eligible to receive assistance (Lowry, 1983, pp. 92-93). By the end of the third year when participation rates leveled off, about 41 percent of eligible renters and 27 percent of eligible homeowners were receiving housing assistance (Lowry, pp.24-25). Data for analysis was collected during the first five years of the experiment in each site. During that period, about 11,000 dwellings were repaired or improved to meet program standards entirely in response to tenant-based assistance and about 5,000 families improved their housing by moving into

apartments already meeting these standards (Lowry, p. 24). This represented more than a nine percent increase in the supply of apartments meeting minimum housing standards. So, tenant-based assistance alone produced a much greater percentage increase in the supply of adequate housing in these localities in five years than all of the federal government's production programs for low-income families have produced in the past 65 years. The annual cost per household was less than $3000 in current prices.

The Supply Experiment sites were chosen to differ greatly in their vacancy rates and the size of their minority populations in order to determine whether the outcomes of an entitlement housing allowance program depend importantly on these factors. At the outset of the Supply Experiment, the vacancy rates in Brown and St. Joseph County were 5.1% and 10.6% (Lowry, p. 53). So the average vacancy rate in the two sites was almost exactly the average vacancy rate in 2000 for U.S. metropolitan areas (7.7%). In 2000, only 26% of the 75 largest metropolitan areas had vacancy rates less than the vacancy rate in Brown County at the outset of the experiment and 20% had vacancy rates greater than the vacancy rate in St. Joseph County. The participation rate differed little between the two sites. Indeed, it was higher in the locality with the lower vacancy rate (Lowry, p.122).

We do not need production programs to increase the supply of apartments meeting minimum housing standards. The Experimental Housing Allowance Program demonstrated beyond any doubt that the supply of apartments meeting minimum housing standards can be increased rapidly by upgrading the existing stock of housing even in tight markets. This happened without any rehabilitation grants to suppliers. It happened

entirely in response to tenant-based assistance that required families to live in apartments meeting the program's standards in order to receive the subsidy.

Those who express concern about the ability of tenant-based assistance to work well in the tightest housing markets usually mention the low success rates in some localities. In discussing this matter, it is important to distinguish between an authority's so-called success rate and its ability to use Section 8 Vouchers. An authority's success rate is the percentage of the families authorized to search for a unit who occupy a unit meeting the program's standards within the housing authority's time limit. An authority's success rate depends on many factors including the local vacancy rate. The most careful study of success rates (Kennedy and Finkel, 1994) indicates that among localities that are the same with respect to other factors those with the lowest vacancy rates have the lowest success rates.

An authority's success rate bears no necessary relationship to the fraction of the authority's vouchers in use at any point in time. No matter what an authority's success rate, the authority can fully use the vouchers allocated to it by authorizing more families to search for apartments than the number of vouchers available. For example, if an authority has a success rate of 50 percent, authorizing twice as many families to search as the number of vouchers available will result in full utilization of the vouchers on average. If each housing authority adjusted its issuance of vouchers to its success rate in this manner, some authorities would exceed their budget and others would fall short in a given year. However, the national average success rate would be very close to 100 percent.

For many years, public housing authorities have over-issued vouchers and thereby achieved high usage rates despite low success rates. In recent years, they have had a reserve fund for this purpose, and current regulations call for penalties on authorities with usage rates below 95 percent. The national average usage rate is high (about 92 percent).

Almost all tenant-based certificates and vouchers are in use at each point in time. Even more would be in use if housing authorities were more aggressive in over-issuing vouchers. Local housing authorities rarely, if ever, return certificates and vouchers to HUD. Although it is true that some families who are offered vouchers do not find housing that suits them and meets the program's standards within their housing authority's time limits, other eligible families in the same locality use these vouchers. This indicates clearly that the problem is not that there are no vacant apartments that meet program standards and are affordable to voucher recipients or apartments whose landlords are willing to upgrade them to meet program standards. In the tightest housing markets, these apartments are more difficult to locate. Unsubsidized families also have trouble locating apartments in tight housing markets.

The real issue is not whether tenant-based vouchers can be used in all market conditions but whether it would be better to use new construction or substantial rehabilitation programs in tight markets. In this regard, the key question is: Will construction programs get eligible families into satisfactory housing faster than tenant-based vouchers in some market conditions?

Based on existing evidence, there can be little doubt that tenant-based vouchers get families into satisfactory housing much faster than any construction program even in the tightest housing markets. Two major studies of success rates under the tenant-based

Section 8 Program have been completed over the past fifteen years (Leger and Kennedy, 1990; Kennedy and Finkel, 1994). These studies collected data on more than 50 local housing authorities selected at random. The lowest success rate observed was 33 percent for New York City in the mid-1980s.[5] If a housing authority with this success rate issued only the vouchers available at each point in time and allowed recipients up to three months to find a unit meeting the program's standards, about 80 percent of new vouchers would be in use within a year. If they followed the current practice of authorizing more families to search for apartments than the number of vouchers available, almost all of the vouchers would be in use within three months.

How long does it take from the time that money is allocated for construction programs to the time that the first units are available for occupancy? Based on data on a national random sample of 800 projects built between 1975 and 1979, Schnare, Pedone, Moss, and Heintz (1982) found the mean time from application for project approval to completion of the project ranged from 23 months for Section 236 to 53 months for conventional public housing. Mean times ranged from 26 to 31 months for the variants of the Section 8 New Construction and Substantial Rehabilitation Program. Occupancy of the completed apartments required additional time. Although the authors did not report results separately for different markets, it seems reasonable to believe that these times were greater in the tightest housing markets because the demand for unsubsidized construction would be greatest in these locations.

[5] The success rate in New York City in the mid-1980s was much lower than the second lowest (47 percent in Boston in the mid-1980s) and much lower than in New York City in 1993 (65 percent). An earlier study based on data from the late 1970s found lower success rates. However, at that time housing authorities were still figuring out how to administer this new program. So these success rates are of no relevance for predicting the effects of expanding the program today.

So if Congress were to simultaneously authorize an equal number of tenant-based vouchers and apartments under any construction program, it is clear that all of the vouchers would be in use long before the first newly built unit was occupied, no matter what the condition of the local housing market at the time that the money is appropriated.

The second major objection to the exclusive reliance on tenant-based assistance is that new construction promotes neighborhood revitalization to a much greater extent than tenant-based assistance. The evidence from the Experimental Housing Allowance Program is that even an entitlement housing voucher program will have modest effects on neighborhoods and the small literature on the Section 8 Voucher Program confirms these findings for a similar non-entitlement program (Lowry, 1993, pp. 205-217; Galster, Tatian, Smith, 1999B). These programs result in the upgrading of many existing dwellings, but this is concentrated on their interiors. It is plausible to believe that a new subsidized project built at low-density in a neighborhood with the worst housing and poorest families would make that neighborhood a more attractive place to live for some years after its construction. The issue is not, however, whether some construction projects lead to neighborhood upgrading. The issues are the magnitude of neighborhood upgrading across all projects under a program over the life of these projects, who benefits from this upgrading, and the extent to which upgrading of one neighborhood leads to the deterioration of other neighborhoods.

The primary beneficiaries of neighborhood upgrading will be the owners of nearby properties. Since the majority of the poorest families are renters, it is plausible to believe that most of the housing surrounding housing projects located in the poorest neighborhoods is rental. Therefore, if a newly built subsidized project makes the

neighborhood a more attractive place to live, the owners of this rental housing will charge higher rents and the value of their property will be greater. Since the occupants of this rental housing could have lived in a nicer neighborhood prior to the project by paying a higher rent, they are hurt by its construction. The poor in the project's neighborhood will benefit from the neighborhood upgrading only to the extent that they own the property surrounding the project.

With the passage of time, the initial residents will leave the neighborhood in response to the project and others who value a better neighborhood more highly will replace them. In short, housing programs involving new construction will shift the location of the worst neighborhoods to some extent. The aforementioned possibilities have not even been recognized in discussions of housing policy, let alone studied.

What has been studied is the extent to which projects under various housing programs affect neighborhood property values. The existing studies find small positive effects on average for some programs and small negative effects for others (Lee, Culhane, and Wachter, 1999; Galster, Smith, Tatian, and Santiago, 1999A; Galster, Tatian, and Smith, 1999B). No study finds substantial positive effects on average for any program.

The consequence of using the costly construction and substantial rehabilitation programs has been that several million of the poorest families who could have been provided with adequate housing at an affordable rent with the money appropriated for housing assistance have continued to live in deplorable housing or paid a substantial fraction of their income to live in adequate housing. We should learn from our past mistakes and not heed the call for a new HUD production program. Indeed, we should go

further and disengage from project-based assistance to existing apartments as soon as current contractual commitments permit.

I appreciate the willingness of members of the Committee to listen to the views of a taxpayer whose only interest in the matters under consideration is to see that tax revenues are used effectively and efficiently to help low-income families.

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