

**FEDERAL SUBSIDIES FOR PUBLIC HOUSING:  
ISSUES AND OPTIONS**

**The Congress of the United States  
Congressional Budget Office**

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Unless otherwise noted, all years referred to in this report are fiscal years.

Details in the tables may not add to totals because of rounding.

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## PREFACE

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This year the Congress is considering proposals to modify the system for subsidizing public housing operations and modernization. This paper, requested by the House Budget Committee, describes the mechanisms for setting subsidy levels and discusses current concerns about the level and distribution of assistance. It compares options for addressing these concerns, ranging from incremental adjustments to new methods of determining subsidy levels.

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In accordance with CBO's mandate to provide objective and impartial analysis, this paper contains no recommendations.

Alice M. Rivlin  
Director

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## SUMMARY

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The public housing program, administered by the Department of Housing and Urban Development (HUD), is the oldest of the direct federal housing assistance programs and one of the largest, aiding 1.2 million households in 1982. Though funded by the federal government, public housing is owned and managed by local public housing authorities (PHAs) and rented to low-income households, which pay no more than 30 percent of their incomes for their housing costs. Because rents are too low to cover costs, the federal government pays a share of ongoing operating expenses, as well as the entire costs of initial construction and subsequent improvements to physically deficient units. Federal expenditures for all these purposes totaled \$2.6 billion in 1982--up from \$860 million a decade earlier.

Public housing is an important resource in meeting the housing needs of low-income households, contributing 10 percent of the housing occupied by very-low-income households <sup>1</sup>/ and as much as 15 percent of the rental housing stock in some cities. Like poor households in general, public housing tenants are far more likely than households renting in the private market to be headed by women and to have above-average numbers of children. About 55 percent of public housing units are occupied by families, most often a single woman with children, and the remaining units are occupied by households with an elderly head, generally a woman living alone. Contrary to many stereotypes, public housing units are, by and large, in reasonably sound condition, though most need some repair. A small subset of units is, however, in very poor condition and would require large expenditures per unit to meet current quality standards.

### ISSUES SURROUNDING THE PUBLIC HOUSING PROGRAM

Pending before the Congress are proposals to modify current mechanisms for subsidizing both operations and physical improvements, which

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1. Under statutory definition, low-income households are those with incomes below 80 percent of the area median, and very-low-income households are those with incomes below 50 percent. Up to 10 percent of the units provided before 1982 and 5 percent of those provided since then may be occupied by households with incomes between 50 and 80 percent of the area median; the rest are reserved for very-low-income households.

would address recent concerns about the way in which funds are allocated and the incentives that exist for efficient management. Funding decisions, however, have wider implications for the public housing program.

In particular, the level of funding and the way in which it is allocated affect the number of units that can be maintained in the public housing stock and the standards that these units meet, both in the short term and in the long run. At relatively low levels of funding, it may not be possible to maintain all units--particularly badly deteriorated ones--at given standards. Higher funding will allow either the repair and maintenance of larger numbers of units or increased quality standards for fewer units. The levels of funding will also determine costs of maintaining standards over time. Relatively high funding now may reduce future costs if used for improvements that reduce operating costs or that prevent later, more costly, maintenance needs. Low levels may save current dollars at the expense of increased future costs resulting from deferred maintenance.

The manner in which subsidies are provided will also affect the quality of public housing, as well as the costs. For example, the Congress could increase flexibility by providing a single subsidy to PHAs for operations and physical improvements, instead of funding these activities separately. This change could result in units that met higher standards or cost less, assuming that managers were enabled to operate more efficiently--for example, by coordinating maintenance and modernization activities. On the other hand, if managers found it difficult to operate without federal guidelines, the result might be lower standards or higher costs. Standards could also vary more over time if, for example, PHAs increased spending on current operations and were unable later to finance needed repairs.

## CURRENT MECHANISMS FOR SUBSIDIZING PUBLIC HOUSING

Operating assistance for public housing is provided through the Performance Funding System (PFS). The modernization of deficient units is financed through the Comprehensive Improvement Assistance Program (CIAP).

### Operating Subsidies

Federal operating subsidies cover the difference between the income received by PHAs--primarily from rent collections--and what are considered to be reasonable measures of operating costs. Allowable operating costs for all expenses except utilities were initially established on the basis of the past costs of a group of PHAs considered to be managed well; costs have

been updated each year to reflect increases in prices and changes in each PHA's operating circumstances. Allowable utility costs are based on average consumption levels over the past three years and on current utility rates. Operating subsidies under this system averaged \$95 per unit per month in 1982, or \$1.3 billion in total. If the system remained unchanged, subsidies under the Performance Funding System would average \$120 per unit per month by 1988, or a total of \$1.6 billion (see Summary Table 1).

### Modernization Subsidies

Through the modernization program, HUD allocates funds on a discretionary basis to PHAs to make comprehensive improvements in selected housing projects. The types of activities undertaken generally involve increasing the energy efficiency of public housing, replacing capital items such as roofs or heating systems, improving the physical condition of projects by repairing exterior and interior walls, and updating kitchen and bath facilities. Between 1980 and 1981, the Congress funded \$3.2 billion in improvements, requiring \$6.1 billion in budget authority to cover the 20-year debt-service costs. <sup>2/</sup> If the same real level of improvements continued to be funded through 1988 as was provided in 1983, budget authority requirements would average \$3 billion per year and \$15 billion over the period--enough to finance a total of \$7.4 billion in improvements.

### Criticisms of the Current System

Though they were introduced as reforms of earlier subsidy systems, these mechanisms have recently aroused concern about the way in which they allocate funds and the effects they have on public housing management. Specific criticisms of the Performance Funding System have focused on the way in which subsidies were initially set and have increased over time. The limits imposed on the operating costs of all PHAs--to levels similar to those of well-run PHAs--may have underestimated the legitimate operating expenses of some PHAs, particularly large urban ones. Further, adjustments in allowable expense levels, meant to compensate PHAs for changes in prices and operating conditions, do not necessarily reflect the actual change in their costs. Some adjustments are complex to calculate,

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2. Capital expenditures for public housing, whether for initial construction or for modernization, are financed through long-term bonds sold by public housing authorities. The federal government pledges to pay the full principal and interest payments on these bonds, however, which for modernization extend 20 years.

SUMMARY TABLE 1. PROJECTED FUNDING LEVELS FOR CURRENT PUBLIC HOUSING SUBSIDY PROGRAMS, 1984-1988

	1984	1985	1986	1987	1988	1984-1988
(dollars per unit per month)						
Performance Funding System <u>a/</u>	106	111	114	117	120	568
Comprehensive Improvement Assistance Program <u>b/</u>	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
(millions of dollars)						
Performance Funding System <u>a/</u>	1,370	1,470	1,500	1,530	1,550	7,420
Comprehensive Improvement Assistance Program <u>b/</u>	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,110	4,370	4,520	4,670	4,810	22,480

SOURCE: Congressional Budget Office.

- a. This excludes subsidies provided for U.S. territories, which are determined outside the Performance Funding System.
- b. This is the budget authority required to fund the same real level of improvements as was provided in 1983. These funds would be spent over 20 years to make debt-service payments on the bonds issued to finance modernization.

particularly in view of the relatively small effects they have. And in some areas it should be possible to increase the incentives for efficient management of public housing.

A central criticism of the modernization procedures is that, because operating funds are separated from improvement funds, PHAs have an incentive to postpone routine maintenance when possible until modernization funds are available, thereby potentially increasing the total cost of achieving the intended quality standard. Further, because funding is available on a project basis, some projects receive extensive improvements while others in similar condition do not.

## OPTIONS FOR MODIFYING THE SUBSIDY MECHANISMS

Concern about the efficiency and equity of the mechanisms for subsidizing public housing has led to several proposals for modifying them. The general approaches include:

- o Incremental adjustments to the funding of operations;
- o An alternative approach to the funding of modernization; and
- o Comprehensive change in the system of setting subsidies for both operations and modernization.

Both the House and Senate Banking Committees have reported legislation, H.R. 1 and S. 1338, that would adjust the funding of operations. The Senate Committee would, in addition, alter the modernization system to provide formula-based subsidies for improvements. The Administration has also proposed formula-based modernization subsidies as one part of a comprehensive change.

## Incremental Changes in the Performance Funding System

Incremental changes could address the specific shortcomings of the PFS without a disruptive shift to a new subsidy mechanism, but would not address the basic concern that past costs are not the appropriate basis for future subsidies.

Alter Allowable Expense Levels. One modification of the PFS would be to adjust the allowable operating costs of those PHAs that are believed to be undercompensated for the actual costs of operating efficiently, as H.R. 1 would direct. Because the data on which initial allowable expenses were based are no longer available, some alternative criterion would be needed to single out PHAs with subsidies deemed to be too high or too low. The costs of such a change would depend in part on the criterion or proxy

selected, which would determine the amount by which subsidies were changed. Alternatively, an appeals process could be established for PHAs to request review of their subsidy levels, and HUD officials could determine whether and how much adjustment was required. An increase in subsidies would increase the number or quality of housing units that could be maintained.

Change Annual Adjustments to Allowable Expense Levels. Each year, nonutility allowable expense levels are adjusted by projected rates of inflation. A year-end retrospective adjustment--like that for utility costs--would ensure that subsidy levels reflected actual, rather than projected, inflation. Such an adjustment is called for in both H.R. 1 and S. 1338. It would probably have only a small effect on total federal costs over several years, but would increase somewhat the complexity of subsidy calculations.

Increase Management Incentives. Other adjustments to the PFS could increase incentives for efficient management. For example, the current practice of subsidizing vacant units could be modified or eliminated, as proposed in S. 1338. Finally, HUD oversight of PHA operations could be reduced for well-managed PHAs and increased for those experiencing difficulties, as considered by the Senate Banking Committee.

### Alternatives for Funding Modernization

Options for altering the present discretionary modernization program have focused on providing formula-based funds to PHAs, which would then be responsible for both short- and long-term maintenance of the public housing stock. This approach, included in both S. 1338 and the Administration's proposal, assumes that, if given responsibility and limited funds, PHAs would develop cost-effective maintenance strategies. On the other hand, the quality of the public housing stock could erode if PHAs were unable to plan effectively or if funding intended for modernization and capital repairs was used instead for current operating costs.

Under the Administration's proposal, PHAs would be responsible for all capital improvements and repairs and would receive additional funding equal to 20 percent of annual nonutility operating costs, which would total \$1.9 billion between 1984 and 1988 (see Summary Table 2). Under S. 1338, PHAs would have responsibility for all but major capital items, which would continue to be funded on a discretionary basis by HUD. <sup>3/</sup> Formula funding

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3. Under S. 1338, HUD would determine the major capital items to be funded on a discretionary basis, with recommendations from a commission of PHA managers, tenants, and local officials.

SUMMARY TABLE 2. PROJECTED SUBSIDIES UNDER ALTERNATIVE MEANS OF FINANCING IMPROVEMENTS TO PUBLIC HOUSING, 1984-1988  
(In millions of dollars)

	1984	1985	1986	1987	1988	1984-1988
Improvements Allowance Set at 20 Percent of Nonutility Operating Costs	340	360	380	400	420	1,900
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Improvements Allowance Set at 15 Percent of Nonutility Operating Costs	250	280	290	300	310	1,430
Capital Reserve Fund <u>a/</u>	<u>160</u>	<u>170</u>	<u>180</u>	<u>180</u>	<u>190</u>	<u>880</u>
Total	410	450	470	480	500	2,310

SOURCE: Congressional Budget Office.

- a. This estimate is based on actual spending for capital items between 1975 and 1979. Future levels might be higher or lower than past levels. Estimates would also be higher if capital improvements were financed through long-term bonds, as is currently the case.

would be set at 15 percent of nonutility operating costs, or an estimated \$1.4 billion between 1984 and 1988, while funding for capital items would depend on annual appropriations.

Under both proposals, additional interim funding is assumed to be required in order to bring units to specified standards, before the PHAs would assume responsibility for future maintenance. The Administration's plan would eliminate about 100,000 current units that would require the most extensive repair, and would fund \$1.7 billion in improvements between

1984 and 1987 to bring the remaining units up to specified standards. S. 1338, by contrast, is not explicit about whether any units are to be removed from the stock and what standards units should meet, and so does not estimate the interim funding for CIAP.

### Comprehensive Change

The final approach--recommended by the Administration--would be to provide the PHAs with one subsidy to cover both current operations and capital improvements, based on the costs of operating privately owned rental units. In effect, the federal government would not subsidize public housing by more than the amount required to assist households to live in private units. The argument for such a change is that present programs contain no means of determining whether the costs of public housing are reasonable, and that it is not efficient to spend more on public housing than on other comparable programs that assist households renting privately-owned units. On the other hand, public housing may differ significantly from private housing in terms of the households assisted and the services provided, in which case the operating costs of public housing could legitimately differ from those in the private market.

Under the Administration's proposal, public housing subsidies between 1984 and 1988 would total \$8.4 billion, of which \$6.5 billion would be assumed to be for operations and \$1.9 billion for improvements, though there would be no requirement that PHAs distribute subsidies in this manner (see Summary Table 3). In addition, as noted, the units most in need of repair would be eliminated from the stock, and the Comprehensive Improvement Assistance Program would be continued through 1987 to bring the remaining units up to minimum standards. Under the Administration's plan, total funding, including transitional modernization funds, would thus be nearly 50 percent lower than if the real level of aid provided in 1983 was extended through 1988; whether this would be sufficient to reach and maintain current quality standards for the remaining units is unclear.

In general, PHAs in the Northeast, where the operating costs of public housing are generally higher than those of modest private housing, would receive lower subsidies intended for ongoing operations under the Administration's plan than they would otherwise. PHAs in other regions would generally, though not always, receive higher amounts. It is difficult to compare the effects of the Administration's plan on modernization efforts, since CIAP funds are distributed on a discretionary basis and since the precise location of high-cost units that would be eliminated is not known.

SUMMARY TABLE 3. PROJECTED FUNDING LEVELS UNDER CBO REESTIMATE OF ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988 <sup>a/</sup>

	1984	1985	1986	1987	1988	1984-1988
(dollars per unit per month)						
FMR Subsidy	126	127	129	132	134	648
Transition Funding for CIAP <sup>b/</sup>	109	76	53	31	--	269
(millions of dollars)						
FMR Subsidy	1,630	1,670	1,690	1,710	1,730	8,430
Transition Funding for CIAP <sup>b/</sup>	1,400	1,000	700	400	--	3,500

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office February 1983 economic forecast.

- a. These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons. First, they exclude costs assumed to be funded outside the FMR system, such as payments to U.S. territories. Second, the Administration's estimates include the effects of proposals to count payments under the Food Stamp program as income in determining rent charges and to raise the maximum increase in rents from 10 percent to 20 percent a year. Other differences arise because of differences between the Administration's economic forecast and that of the Congressional Budget Office. Finally, the data bases used in producing the two sets of estimates vary, producing minor differences in the results.
- b. This is the budget authority required to pay the debt service on bonds issued to finance CIAP activities.



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## CHAPTER I. INTRODUCTION

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Since 1937, the public housing program has been one of the major federal vehicles for improving the housing conditions of low-income households, currently aiding 1.2 million households or about one-third of all those receiving assistance. The federal government pays the entire debt-service costs of initial construction and subsequent modernization of public housing and, in addition, subsidizes ongoing operations. The system for setting these subsidies--particularly for modernization and operations--has been the focus of growing criticism on the grounds that it lacks incentives for efficient management and is inequitable in its distribution of funds. Several major proposals have been made this year to modify federal support for public housing, and the House and Senate Banking Committees have each reported housing legislation that deals extensively with public housing.

This report considers the issues that currently surround federal subsidies for public housing, and options for addressing them. The remainder of this chapter provides background on the development of the public housing program and the shift of federal emphasis away from public housing toward subsidies for households renting in the private market. Chapter II describes the households served by public housing and the current condition of the public housing stock. Chapter III outlines the major issues surrounding the public housing program. Chapter IV explains the system used to support public housing, and the concerns that have been raised about it. Chapter V describes options for modifying federal subsidies, either through adjusting current subsidy programs or by developing an entirely new system.

### THE DEVELOPMENT OF THE PUBLIC HOUSING PROGRAM

The public housing program was created as part of federal efforts to stimulate employment and offset the effects of the Depression. 1/

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1. For further discussion of the development of the public housing program, see: The Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982); Robert Kolodny, Exploring New Strategies for Improving Public Housing Management, prepared for the Department of Housing and Urban Development, 1979; Robert Moore Fisher, Twenty Years of Public Housing (Harper and Brothers, 1959).