

utility costs that are reconciled with actual levels after the close of the year, no adjustment is made for differences between expected and actual inflation. Such adjustments would help ensure that but they could also add to the complexity of the system. Both H.R. 1 and S. 1338 would modify it in this manner.

One question in making adjustments is whether subsidies themselves should be retrospectively raised or lowered, or whether only the allowable expense levels on which subsidies are based should be adjusted. Because the data on actual rates of inflation would not be available by the close of a year, retrospective adjustments for actual inflation would also lag. Adjusting subsidy levels would mean that funding levels over time would reflect actual levels of inflation, but the timing of such adjustment could pose problems. For example, if inflation were predicted at 6 percent and reached only 4 percent in one year, PHAs would receive a 2 percent reduction in subsidy two years later. If in the subsequent year inflation were projected at 6 percent, PHAs would receive a net increase of 4 percent. If, however, actual inflation in the subsequent year were 8 percent, then funding would be 4 percent less than actual costs. Conversely, PHAs could be relatively overfunded in other years if inflation was over predicted. Thus, while, on net, subsidies would reflect actual costs, the lag in adjustments could produce short-term funding difficulties.

An alternative would be to adjust allowable expense levels each year by the most recent actual rate of inflation before projecting them to future years, but not to adjust past subsidy levels. This was the procedure used in 1982 when expense levels were updated. On the one hand, this would prevent allowable expense levels from straying further and further away from the actual levels, as they could if, for example, inflation were consistently underestimated. It would also prevent PHAs from receiving larger or smaller subsidies in the current year than are expected to be required. On the other hand, it would mean that PHAs would not necessarily receive the same real level of subsidies over time.

The effects of retrospective inflation adjustments on federal costs would depend on how the adjustments are implemented, but they would probably be small. In 1982, a one-time retrospective adjustment to allowable expense levels was made for underestimates of inflation between 1977 and 1981, raising them by 4.9 percent. This increased federal subsidies by \$67 million in 1982 and will increase future year subsidies over the levels they otherwise would have reached. This estimate, however, probably overstates the costs of future adjustments, because a large part of the increase resulted from the substitution of the composite index of wages and purchases for the former index that relied solely on wages (see Chapter IV for details).

Reconciling Differences Between Expected and Actual Tenant Rents. Operating subsidy calculations could also be modified by reconciling subsidy estimates for the differences between expected and actual tenant rents. Currently, the average rent at the end of a year is raised by an assumed rate of increase in tenant incomes to calculate a PHA's rental income in the coming year. While an appeals process exists to raise subsidies for PHAs where rents are not rising as rapidly as expected, no mechanism exists to recapture subsidies where rents were higher than expected.

Establishing a system of year-end adjustments to rent revenues would lower federal costs, though the exact amount would depend on how much more rents increased than expected, and would also end additional subsidies to PHAs whose tenants' incomes rise faster than expected. On the other hand, it would add somewhat to the complexity of the subsidy system. Further, it would require that PHAs carefully monitor their revenues during a year and set aside the amounts that were more than anticipated, to offset the reduction in the following year's subsidy.

Simplifying the Annual Adjustment for Changes in the Housing Stock. Another concern raised about subsidy calculations is the manner in which the annual adjustment is made for changes in the public housing stock. The adjustment is small--between 1977 and 1981, it averaged from 0.1 to 0.7 percent--and its calculation is complex.

One option would be to replace the current adjustment factor, which varies for each PHA, with a constant factor for all PHAs. This would simplify the estimation of this factor every year, but would not allow for the impact of adding new units or substantially improving existing ones.

Alternatively, the current practice of estimating the change factor could be limited to PHAs experiencing some major change in their stock of units, and a constant factor applied to the remaining PHAs--the approach included in H.R. 1. This would be somewhat more complicated than using a single adjustment factor, but simpler than the current system. In either case, such modifications would have negligible effects on federal costs.

#### Increasing Management Incentives Under the Performance Funding System

The PFS is designed as an incentive-based system: public housing managers are provided a formula-determined expense level and, to the extent that they keep actual costs below this level, are able to use the excess funds as desired. Incentives for PHA managers to perform their tasks efficiently could be expanded, however, thus potentially reducing federal costs or increasing the assistance provided.

Providing Full Subsidies Only for Occupied Units. At present, federal subsidies cover all units managed by a PHA unless HUD and the PHA have formally agreed to withdraw a unit from the stock. This means that PHAs do not have incentives to minimize the duration of vacancies, and to the extent that this reduces rent payments it raises federal subsidy costs. Further, since vacant units are more apt to be vandalized than occupied ones, it may increase the need for federal modernization funds.

PHAs could be encouraged to maintain full occupancy by reducing subsidies for units that are vacant longer than is required for tenant turnover. The strongest incentive would be to provide no subsidy for vacant units. S. 1338 would eliminate subsidies for vacant units in excess of 2 percent in 1984, in excess of 1 percent in 1985, and for all vacant units beginning in 1986.

On the other hand, even vacant units require some expenditure for heat, security, and other needs. Another option would be to provide subsidies for a limited period of time and then to eliminate subsequent subsidies, unless the vacancy was necessary for planned modernization work. Or, partial subsidies could be provided for part or all of the vacancy period. For example, in the Section 8 new construction program, subsidies equal to 80 percent of rent levels are provided for 60 days. Making some adjustment for vacancies would increase management incentives, but it would also increase the complexity of subsidy calculations under the PFS.

The effect of limiting subsidies for vacant units would depend on the manner in which the limit was applied and on the effect it had on public housing occupancy rates. HUD officials estimate that vacancy rates average from 5 to 8 percent but vary widely by PHA, with some having very low vacancy rates and a few having high rates. If reducing subsidy levels for vacant units caused PHAs to increase occupancy rates, then subsidy levels--and therefore federal costs--would change little. If, however, PHAs, particularly with high vacancies, did not or could not reduce vacancy rates, then subsidies could fall by up to the vacancy rate, depending on the way the limit was applied.

Assisting Public Housing Authorities with Management Difficulties. Another option for increasing management incentives would be to reduce oversight of PHAs considered to be managed well and use the savings for increased review of those experiencing difficulties. Performance standards could be established either by the PHAs themselves through a peer process or by HUD. The Senate Banking Committee has considered both approaches.

Under the peer review process included in S. 1338, a commission to establish performance standards for public housing management would be

chosen by the Secretary of HUD (see Appendix C for further details). The commission would consist of representatives of public housing authorities, local governments, and tenants who would recommend standards for the management of public housing and procedures for evaluating PHAs.

A plan, included in the housing bill reported last year by the Senate Banking Committee, would have required the Secretary of HUD to evaluate PHAs, designating them as either Tier A or Tier B authorities depending on their operations. Tier A PHAs would be eligible to receive multiyear subsidy payments from HUD and would be granted maximum flexibility in managing their affairs. Tier B agencies would receive only one-year subsidy payments and would be eligible for special assistance in order to improve management and gain accreditation.

These approaches would focus attention on PHAs experiencing management difficulties and increase HUD's oversight of them. Their success would depend on the ability of the peer review commission or HUD officials to develop and apply meaningful standards for the management of public housing and to assist PHAs that did not meet such standards. The willingness of PHAs to participate would also affect their success. The cost of such approaches would depend on the manner in which they were implemented and the extent to which current review efforts were reduced.

#### OPTIONS FOR MODIFYING THE MODERNIZATION PROGRAM

Two issues have been raised about the manner in which improvements to the public housing stock are planned and financed. First, because funding is available on a discretionary basis, PHAs cannot be assured of receiving funds at the time they are most needed. Thus, when funds are available, PHAs have an incentive to make repairs that could have been postponed--such as replacing all of the roofs in a project, even though only some are worn out. Second, because funding for improvements is provided separately from funding for operations, PHAs have an incentive to defer maintenance projects until Comprehensive Improvement Assistance Program funds are available, rather than performing ongoing maintenance.

Proposals have been made to fund modernization jointly with operating subsidies. Managers would then know the amounts to expect and have an incentive to consider the long-term consequences of their operating decisions. The quality of public housing might erode under such an approach, however, if funding levels were set too low or if PHAs were unable to budget efficiently and used funding intended for improvements to meet their operating expenses.

Such a formula-based program would require decisions about the scope and level of funding, the limitations to be applied to the use of funds, and the method of funding during the transition period.

### Design of a Formula-Based Improvements Program

Two models for formula-based modernization have been proposed: one would provide a single source of funding from which PHAs would be expected to fund all maintenance and capital needs, while the other would provide formula-based funding for all but major capital items, the latter to be financed through a separate, discretionary grant program operated by HUD.

A Comprehensive Approach. The Administration has proposed that PHAs be provided with a single source of funding from which they would finance ongoing improvements and major capital items, as well as operations. The level of funding required to maintain the public housing stock on an ongoing basis is difficult to estimate and would depend on the standards that PHAs were expected to meet and the age of a PHA's units. The Administration has proposed that an amount equal to 20 percent of a PHA's annual nonutility operating expenses (that is, allowable expense levels under the Performance Funding System) would be sufficient to maintain HUD's minimum property standards. If funding was set at 20 percent of allowable expense levels, the program would cost \$340 million in 1984 (see Table 7), and \$1.9 billion for the 1984-1988 period.

The Congress might want further information before making a final decision on an appropriate funding level, however. First, the estimate that capital expenditures equal 20 percent of nonutility operating costs is based on a single year's expenditures for a sample of privately owned rental projects insured by the Federal Housing Administration.<sup>3/</sup> Second, even if all units met a prescribed standard--discussed later--PHAs with relatively old units might have a different pattern of capital expenditures than those with relatively newer ones. For example, even if the heating systems work equally well in a 5-year old project and a 20-year old one, it is likely that the older system will require replacement sooner than the newer one. Over the long term, expenditures might be similar for older and newer projects; in the short term, however, the spending requirements could differ widely, thus affecting the funding necessary for different PHAs to maintain the same quality standards.

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3. See: Urban Systems Research and Engineering, Inc., Capital Replacement Expenditures in FHA Multifamily Housing Projects: Implications for Addressing the Modernization Needs of Public Housing (1983).

TABLE 7. FUNDING FOR THE PERFORMANCE FUNDING SYSTEM AND A FORMULA-BASED IMPROVEMENTS PROGRAM UNDER A RANGE OF ASSUMPTIONS, 1984-1988 (In millions of dollars)

	1984	1985	1986	1987	1988	1984-1988
Performance Funding System <u>a/</u>	1,370	1,470	1,500	1,530	1,550	7,420
Improvements Allowance Set at 20 Percent of Allowable Expense Levels	<u>340</u>	<u>370</u>	<u>380</u>	<u>400</u>	<u>420</u>	<u>1,910</u>
Total	1,710	1,840	1,880	1,930	1,970	9,330
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Performance Funding System <u>a/</u>	1,370	1,470	1,500	1,530	1,550	7,420
Improvements Allowance Set at 15 Percent of Allowable Expense Levels	250	280	290	300	310	1,430
Capital Reserve Fund <u>b/</u>	<u>160</u>	<u>170</u>	<u>180</u>	<u>180</u>	<u>190</u>	<u>880</u>
Total	1,780	1,920	1,970	2,010	2,050	9,730

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 midwinter 1983 economic forecast.

- a. Excludes federal subsidies for U.S. territories paid outside the Performance Funding System. Estimates of funding under the Administration's plan by size of public housing authority and region are included in Appendix B.
- b. This estimate is based on actual spending for capital items between 1975 and 1979. Future levels may be higher or lower than past levels. If a capital reserve fund was financed through 20-year bonds, the budget authority requirements would be about twice as high as these estimates.

A Two-Part Approach. An alternative approach would be to provide formula-based funding for routine maintenance and a discretionary reserve fund for major capital items. Under a plan considered in a recent HUD study, three items would be eligible for funding through the capital reserve fund--roofs, heating systems, and utility distribution systems--and all remaining improvements would be funded through the improvements allowance. 4/ Under S. 1338, which also adopts this approach, the activities to be funded through each mechanism would be determined by HUD, with recommendations from the commission that would be appointed to consider management standards. In either case, HUD would retain responsibility for allocating capital replacement funds among PHAs. This approach would make it easier to take account of the different ages of PHAs' housing, since major capital items would be funded separately, but it would require continued federal involvement in PHAs' decision making.

The funding required for such a system should, over time, be the same as for a comprehensive formula-based program, but could vary considerably from year to year as capital needs varied. 5/ A survey of private housing managers has estimated that an improvements allowance equal to 12 to 15 percent of a PHA's nonutility operating costs could be sufficient to maintain minimum property standards, if a capital reserve fund was established for roofs and for heating and utility distribution systems. In the Senate plan, funding for the improvements allowance would be set at 15 percent of nonutility operating expenses, and capital reserve funds would be determined on the basis of joint recommendations from HUD and the commission.

Adding a replacement allowance set at 15 percent of allowable expense levels defined under the PFS would require \$250 million in 1984 and \$1.4 billion from 1984 to 1988 (see Table 7). The expenditures for a capital reserve would be difficult to project, however. If major improvements were made to public housing during the transition to a new system, presumably little funding for capital items would be needed in the near term. Without substantial transition funding for modernization, the near-term capital needs would be larger. Major capital items funded from 1975 to 1979

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4. See Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 7.
  5. Although funding requirements would, over time, be the same under a comprehensive and a two-part approach, actual costs could vary. Since the funding for major capital items under a two-part plan would be discretionary, the Congress might or might not provide the same amount over time as it would if it chose the comprehensive approach.

averaged \$160 million per year in 1984 dollars, although there is little evidence to suggest whether future capital costs would be higher or lower than this average. If this real level of capital spending was continued through 1988, capital costs would total \$880 million. If these costs were financed through 20-year bonds, as under the Comprehensive Improvement Assistance Program, then the budget authority to finance this level would be roughly \$1.8 billion.

### Constraints on the Use of Funds

In establishing a formula-based replacement allowance, the Congress would need to consider whether to attach limitations to PHAs' use of funds. Possible constraints could include requiring that PHAs establish a project-based capital replacement fund to ensure that future needs be met, or that they develop long-term capital plans. Some PHAs might have difficulty in planning efficiently for the expenditure of these funds, and technical assistance could be provided to help them develop plans. Such constraints could help ensure that PHAs did not use the entire federal subsidy for near-term operating expenses. On the other hand, if the intent of a formula-based replacement allowance is to shift responsibility to PHAs, then the Congress may consider such restrictions unnecessary or undesirable.

### The Transition to a Formula-Based Modernization Plan

Proposals for a formula-based improvements program assume that PHAs could maintain standard-quality units if they were provided a stable and ongoing source of funds. Because some units do not currently meet such standards, as discussed in Chapter II, these proposals include a transition period during which Comprehensive Improvement Assistance funds would continue to be provided to bring some or all public housing units to prescribed standards of quality.

The CIAP funding required for a transition would depend on how many units were to be modernized and on what standards were set for improvement projects. Bringing all units in the public housing stock up to Level III standards could require improvements totaling \$10 billion, and \$20 billion in budget authority (see Chapter II). Under the Administration's plan, some 100,000 units most in need of repair would be withdrawn from the public housing stock; all others would be brought up to HUD's minimum property standards (Level II); and energy conservation improvements would be made. The Administration estimates that this would require \$1.7 billion in improvements and \$3.5 billion in budget authority, assuming that no deterioration has taken place since 1980 and that no CIAP funds since 1980

have been used on distressed projects or for activities above Level II. Under S. 1338, \$1.6 billion in budget authority--enough to finance about \$800 million in improvements--would be provided for CIAP in 1984, to bring as many units as possible to "habitability standards," which are not further defined. CIAP funds would be continued after 1984 only for PHAs whose units failed to meet such standards.

#### OPTIONS FOR BASING SUBSIDIES ON PRIVATE-MARKET RENTS

The Administration and others have proposed that current programs for subsidizing public housing be replaced with a single subsidy based on the same private-market rent standards that are used in the Section 8 existing housing program.<sup>6/</sup> Such an approach would modify current programs in two fundamental ways. First, it would base subsidy levels on private rent levels used in other programs, rather than on past funding levels for public housing. The Administration and others who advocate this system argue that it would provide a benchmark for determining whether funding levels for public housing are reasonable, whereas under the current system no such external standard exists. Second, PHAs would receive a single subsidy covering both operating expenses and costs of improvements. Since funding for improvements would be guaranteed rather than discretionary, PHAs would be able to plan improvements and would have an incentive to seek cost-effective means of maintaining the public housing stock.

Those opposed to the Administration's plan argue that the types of tenants served and the aid provided by public housing differ significantly from those of privately owned rental units. Further, they believe that private-market rents would overstate the operating costs of public housing in markets where private rental units are highly profitable and would understate costs where they are not. For those reasons, they maintain, private rents are not appropriate measures of public housing operating costs.

#### The Administration's Proposal

Under the Administration's proposal, federal subsidies for operations and for improvements would be combined into one payment based on Fair Market Rents (FMRs), which are market rent levels determined annually by HUD for over 2,500 areas in setting subsidy levels in the Section 8 existing-housing program. An FMR would be the 40th percentile of rents of all

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6. See: Raymond J. Struyk, A New System for Public Housing (Urban Institute, 1980).

standard-quality units in an area, excluding those built in the past two years. <sup>7/</sup> FMRs would be adjusted to reflect the distribution of units with varying numbers of bedrooms owned by each PHA, the proportion of tenants who pay their own utilities, and the number of units in family projects over five stories high. Then, from each PHA's FMR would be subtracted the lesser of the PHA's actual debt service or 20 percent of the adjusted FMR value. This cap on debt service would limit each PHA's debt-service costs to HUD estimates of the average debt service for private-market rental units.

Federal subsidies would be set at the difference between adjusted FMRs and PHA income. Under the Administration's proposal, subsidies would be paid only for occupied, standard-quality units. The Administration plan may be summarized:

Basic Subsidy Under Administra- tion's Proposal	=	Funding Level Based on Adjusted FMR	—	Lesser of: (1) Debt Service, or (2) 20 percent of Adjusted FMR	—	PHA Income
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The Administration also proposes a transition period during which a PHA would receive a subsidy based on the FMR unless this amount would be less than a minimum or more than a maximum subsidy level. In 1984, PHAs would receive subsidies very similar to those they would have otherwise received. In later years, the minimum would decline and the maximum would increase, so that subsidy levels could move further and further from the levels they would otherwise have reached.

In addition, the Administration would continue the Comprehensive Improvement Assistance Program through 1987 to bring all but badly deteriorated units up to HUD's minimum property standards; the units in worst repair would be removed from the stock, thus reducing the size of the inventory. The Administration estimates that this would require \$1.7 billion in improvements, or \$3.5 billion in budget authority, as discussed earlier.

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7. The 40th percentile is the rent that is less than 60 percent of the rents in an area and greater than 40 percent.

TABLE 8. PROJECTED FUNDING LEVELS UNDER CBO REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988 a/

	1984	1985	1986	1987	1988	1984-1988
	(dollars per unit per month)					
Subsidy for Operations <u>b/</u>	100	100	100	101	102	503
Subsidy for Improvements <u>c/</u>	<u>26</u>	<u>27</u>	<u>29</u>	<u>31</u>	<u>32</u>	<u>114</u>
Total FMR Subsidy	126	127	129	132	134	648
Transition Funding for CIAP (In dollars of budget authority)	109	76	53	31	--	269
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	(millions of dollars)					
Subsidy for Operations <u>b/</u>	1,290	1,310	1,310	1,310	1,310	6,530
Subsidy for Improvements <u>c/</u>	<u>340</u>	<u>360</u>	<u>380</u>	<u>400</u>	<u>420</u>	<u>1,900</u>
Total FMR Subsidy	1,630	1,670	1,690	1,710	1,730	8,430
Transition Funding for CIAP (In millions of dollars of budget authority)	1,400	1,000	700	400	--	3,500

Subsidy Levels Under the Administration's Plan. Under the Administration's proposal, FMR-based subsidies for public housing would total \$1.6 billion in 1984 and \$8.4 billion from 1984 to 1988 (see Table 8). 8/ In addition, \$3.5 billion in budget authority--to finance \$1.7 billion in improvements--would be allocated to CIAP between 1984 and 1987, making total funding for public housing \$11.9 billion over the period.

8. These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons (see Table 8, a/).

TABLE 8. (Continued)

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SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on public housing authority 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 midwinter 1983 economic forecast.

- a. Components of the FMR subsidy and estimates of funding under the Administration's plan by size of public housing authority and region are included in Appendix B.

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 use of different data bases produced minor differences in the results.

- b. Total subsidy minus that portion assumed to be used for improvement needs, defined as 20 percent of nonutility allowable expense levels calculated under the Performance Funding System (PFS).
- c. Defined as 20 percent of nonutility allowable expense levels calculated under the PFS.

Under the Administration's plan, PHAs would have complete discretion in allocating funds between current operations and capital improvements. If, however, capital improvements would require roughly 20 percent of nonutility operating costs, then the funding that would be available for operations under the FMR plan would total \$1.3 billion in 1984, 6 percent below the projected PFS level. It would grow by just 2 percent between 1984 and 1988, so that between 1984 and 1988 operating subsidies under the Administration's plan would total \$6.5 billion. This would be \$900 million--or 14 percent--less than projected under the PFS.

Under the Administration's plan, PHAs would also have a formula-based subsidy for improvements that would total \$1.9 billion between 1984 and 1988, assumed to be equal to 20 percent of nonutility operating costs. The FMR-based improvements funding would be available for ongoing operating costs, if PHAs chose to use them for such activities, though using these funds for current operating needs could mean that PHAs would have difficulty adequately maintaining the public housing stock.

The Effects of the Administration's Plan. The Administration's plan is designed in such a way that in 1984 PHAs would receive operating subsidies similar to those that they would have received under the PFS (see Table 9). Beginning in 1985, however, the constraints that would produce such results would gradually be lifted. By 1988, 60 percent of all units would be located in PHAs receiving less for operating under the FMR system than they would have received under the PFS, and for 38 percent of all units this difference greater than 10 percent. In contrast, 22 percent of all public housing units would be located in PHAs receiving increases in their operating subsidies of over 10 percent.

By region, most public housing outside the Northeast would receive higher operating subsidies under the Administration's plan than under the PFS, while most public housing in the Northeast would receive less (see Appendix B, Tables B-5 to B-8). In 1988, when the transition would be virtually complete, PHAs in the West managing all but 21 percent of the units located there would receive at least as much under the Administration's plan as they would have under the PFS--and generally more. Similarly, PHAs managing 60 percent of the units in the South and in the Central regions would be at least as well off. In contrast, only 9 percent of the units in the Northeast would be located in PHAs that had operating subsidies at least as large as they would have had under the PFS; for 62 percent, the reduction in subsidy relative to the PFS would be 25 percent or more.

Estimating the effects of the Administration's proposal for funding improvements to public housing is more difficult. Since modernization funds are currently allocated on a discretionary basis to a limited number of PHAs each year, the change would mean that many PHAs would receive more funding than they otherwise would in any one year, and some would probably receive more than they would have over a period of several years. This could lead to improved conditions in at least some public housing projects. On the other hand, little evidence exists on the annual funding levels required to maintain the public housing stock. The Administration argues that adequate ongoing improvements could be funded with the equivalent of 20 percent of nonutility operating costs. If, however, public housing requires higher levels than private housing--because, for example, it serves larger families or is more prone to vandalism--then these levels could be

TABLE 9. EFFECTS OF THE ADMINISTRATION'S PROPOSAL: CHANGES IN OPERATING SUBSIDIES a/ FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATES OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM, 1984-1988 (Percent distribution of public housing units) b/

Change from PFS to FMR	1984	1985	1986	1987	1988
-50 Percent or More	--	1	2	3	4
-49 to -25	1	5	22	22	24
-24 to -10	22	29	12	11	10
-9 to -1	21	12	17	21	22
No Change	57	20	14	10	5
+1 to +10	c/	28	19	15	12
+11 to +25	c/	5	12	13	13
+26 to +50	c/	1	2	4	6
+More Than 50	c/	d/	2	2	3

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.

-- Indicates that no units fall within that category.

- a. Operating subsidies are total federal subsidies under the Administration's FMR proposal minus the amount assumed to be necessary for improvements, which the Administration defines as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.
- b. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System.
- c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received under the PFS.
- d. Less than 0.5 percent.

inadequate. Or, if some PHAs used some of the funding assumed to be necessary for improvements for operating expenses--as could be the case for those that would experience large declines in operating subsidies--then funding for future improvements would not be available.

Whether \$3.5 billion in transition funding for CIAP would be sufficient depends on the physical quality standard selected and on the assumptions made about deterioration in the public housing stock since 1980. The Administration's estimate assumes that the units identified as distressed would be eliminated and that HUD's minimum property standards would be applied. It also assumes that the stock has not deteriorated since 1980 and that funding has not been used since 1980 to upgrade badly deteriorated projects. It is likely, therefore, that even to achieve the Administration's goals would require additional funding, and the budget authority requirements for a transition modernization program could be as high as \$20 billion, if the Congress chose other standards in designing the program or maintained all existing units.

#### Modifications of the Administration's Plan

The Congress could endorse the Administration's assertion that public housing subsidies should be set on the same basis as other federal housing subsidies, but could modify the manner in which the change was implemented. Specific possibilities include:

- o Setting the FMR standard at a different point in the distribution of rents;
- o Including a different segment of the market in the FMR distribution, such as only rents paid by households that have moved recently, or the rents paid by all households including those in newly built units, or rents paid by all households except those in subsidized units;
- o Making additional or fewer adjustments for differences between public and private housing, in terms of the relative characteristics of both housing units and tenants served;
- o Funding major capital items separately;
- o Modifying the length of the transition from current programs to the new system; or
- o Establishing other minimum and maximum funding levels.

The effect of such modifications would depend on the purposes for which they were intended and the manner in which they were structured. For example, the Congress could decide that FMRs should be established at the midpoint, rather than the 40th percentile, in the distribution of rents so that PHAs would have the same resources as are available to the average private manager. Or, if the Congress felt that the differences between public and private rental tenants described in Chapter II were significant enough to affect their relative operating costs, it could modify FMR levels to account for such variation. Or, the Congress could modify the length of the transition between the two funding systems, by either shortening or extending it relative to the Administration's plan.

For example, if the Congress established FMR levels at the 45th percentile in the distribution of rents paid by recent movers--a measure designed to reflect current market conditions and to allow PHAs operating levels more comparable to those of average private-market managers--total subsidies would increase to \$1.7 billion in 1984 and to \$9.3 billion for the 1984-1988 period. Based on the Administration's estimate that 20 percent of nonutility operating costs would be needed for improvements, total operating subsidies under this approach would be within 1 percent of the levels that they are projected to reach under the PFS. Fewer PHAs in each region would experience reductions in subsidy levels than under the Administration's plan, though a higher proportion of the PHAs in the Northeast would be adversely affected than in other regions.

Or, if the Congress determined that the operating costs of public projects with three and four bedrooms are higher than those of comparable private projects because of the larger numbers of children per household, it could increase subsidies for such units. Doing so might increase FMR-based subsidies to \$1.6 billion in 1984 and to \$8.6 billion for the five-year period. This would raise subsidies for PHAs in all regions, relative to the Administration's plan, and would, in particular, offset some of the large reductions that PHAs in the Northeast would otherwise experience.

Adjustments of these types to the Administration's plan could enable the Congress to set service levels for public housing at the levels considered appropriate and to ensure that the transition from one system to the other did not produce large short-term or long-term disruptions and inefficiencies. These adjustments could raise or lower costs from the Administration's plan, depending on their precise nature.



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## APPENDIX A. GEOGRAPHIC REGIONS

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The regions used in tables in this paper are those defined by the Department of Housing and Urban Development. The states or territories included in each region are:

- Northeast:** Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, New Jersey, New York, Puerto Rico, Virgin Islands, Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia
- Central:** Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin, Arkansas, Louisiana, New Mexico, Oklahoma, Texas, Iowa, Kansas, Missouri, Nebraska
- South:** Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee
- West:** Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming, Arizona, California, Hawaii, Nevada, Arkansas, Idaho, Oregon, Washington



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**APPENDIX B. DETAILED INFORMATION ON PROJECTED FUNDING  
LEVELS UNDER CURRENT PROGRAMS AND UNDER CBO  
REESTIMATES OF THE ADMINISTRATION'S PROPOSAL**

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TABLE B-1. PROJECTED FUNDING LEVELS UNDER THE PERFORMANCE FUNDING SYSTEM (PFS) AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), BY COMPONENT OF SUBSIDY, 1984-1988

	1984	1985	1986	1987	1988	1984- 1988
Average Funding Level (dollars per unit per month)						
PFS						
Operating Expenses <u>a/</u>	219	230	241	252	264	1,206
PHA Income <u>b/</u>	113	119	127	136	144	639
Federal Subsidy (Expenses Less Income) <u>c/</u>	106	111	114	117	120	568
CIAP <u>d/</u>	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
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Total Funding (millions of dollars)						
PFS						
Operating Expenses <u>a/</u>	2,850	3,070	3,200	3,320	3,440	15,880
PHA Income <u>b/</u>	1,480	1,600	1,700	1,800	1,890	8,460
PFS Subsidy (Expenses Less Income) <u>c/</u>	1,370	1,470	1,500	1,530	1,550	7,420
Total Federal Subsidy <u>e/</u>	1,420	1,520	1,560	1,590	1,610	7,700
CIAP <u>d/</u>	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,160	4,420	4,580	4,730	4,870	22,770

SOURCE: The Congressional Budget Office.