

The Bush Administration's
Proposed FY2004 Cuts to

Housing Resources for Low-Income Families and Communities

- ★ Operating Subsidy
- ★ The HOPE VI Program
- ★ The Capital Fund



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building communities together

Public housing provides quality affordable housing for more than 3 million low-income individuals nationwide. A key factor in the nation's housing policy since the early 1930s, the federal government has committed \$30 billion over the past five years in operating subsidies and capital improvement support for property assets valued at \$100 billion.

But now that commitment is changing. The current administration proposes to eliminate the successful HOPE VI program, worth nearly \$600 million a year to renew communities devastated by poverty and disinvestment. It has already eliminated the Public Housing Drug Elimination Program (PHDEP) grant, which provided more than \$300 million for fighting drug crime, in 2001. The Operating Subsidy program is failing under HUD mismanagement, leaving some housing agencies with only half the subsidy needed to manage properties. The Capital Fund is besieged by set-asides and chronically low funding levels that reduce agencies' ability to provide quality housing.



Operating Subsidy — 50 percent, 70 percent or 90 percent?

Each year, housing agencies submit requests to HUD for operating subsidy. In FY 2003, the public housing operating fund received \$3.6 billion. Of that amount, \$250 million will be used to cover a funding shortfall that affected a quarter of all agencies in FY 2002. Table 1 provides a history of operating subsidy and the “prorated amount.” Depending on the total amount of subsidy requested, the amount appropriated, and other factors, HUD distributes 100 percent or less of requested need for subsidy. Simply put, the subsidy is the difference between what the agency collects in rents and the amount needed to operate its facilities. The difference between receiving 100 percent of subsidy need, or less, is the difference between financially stable, well-run agencies and agencies at risk.

Table 1. Operating Subsidy Proration History

Federal Fiscal Year	Appropriated Amount (billions)	Percent of Need Funded (prorated amount)
1999	\$2.818	92.5%
2000	\$3.138	98.5%
2001	\$3.242	99.5%
2002	\$3.495 (\$250 million short)	100% (Oct. 1 agencies at 50%)
2003	\$3.600	70% until further notice (\$250 m to address shortfall)
2004	\$3.574	HUD budget proposal request

Unlike their private-sector counterparts, public housing administrators cannot raise rents to cover costs. Federal law prohibits residents of public housing from paying more than 30 percent of their income for rent. The average household income in public housing is under \$10,000 per year. Operating subsidy is necessary to sustain these communities. The subsidy is provided to agencies under an “annual contributions contract” with HUD, which spells out responsibilities for both HUD and local housing agencies. If funds are insufficient, housing agencies can survive on reserves for short periods, but soon cut services to residents, lay off staff, and otherwise contract operations to fit within the available funds. Agencies now operating at 50 percent of need are invoking these budget-cutting moves.

The 50 Percent Problem

At the beginning of FY 2002, HUD announced that the proration for that year would be 100 percent of need. But as HUD began distributing funds in FY 2002, it discovered that there were insufficient funds — by \$250 million — to cover agencies with a fiscal year start of Oct. 1, 2002. This is the last group of agencies to be funded from FY 2002 appropriations. HUD cut funding to these agencies to 50 percent of need.

The FY 2003 appropriations bill allows HUD to use up to \$250 million of the \$3.6 billion appropriated to address this problem, but expressly forbids HUD to continue the practice. The department has used funds from an upcoming year to satisfy the budget for a current year over the past several years. Using these funds for FY 02 immediately reduces the amount available for FY 03 to an unacceptable level.



The 745 agencies now operating at 50 percent may not have access to those funds until April 2003. Of all Oct. 1 agencies¹, 89 percent own and manage less than 500 units. These small agencies do not have sufficient reserves to bridge the gap for more than a few months.

The 70 Percent Problem

The department is funding Jan. 1 agencies at 70 percent of their requested amount for several reasons, apparently as a cautionary hedge against several

unknowns. HUD will not know the amount agencies will request for FY 2003 until this spring, and is unsure of its internal financial management systems for the Operating Fund. HUD says both these circumstances led to the FY 02 shortfall. By funding the Jan. 1 agencies at 70 percent, the department could hold funds in reserve until the 2003 subsidy requests are known, thus avoiding a repeat of the FY 2002 disaster.

¹ Housing agencies are grouped in four fiscal years, beginning on Jan. 1, April 1, July 1, or Oct. 1. There are about 800 agencies in each group.

HUD issued a schedule by which agencies must submit requests for FY 2003 subsidy. The last date is May 2003. After this, it may take HUD 60 to 90 days to compute subsidy awards for each agency, and to distribute the funds. If so, funds will not reach agencies until June or July 2003. If the funding level is more than 70 percent, it is unclear whether agencies will receive the difference between 70 percent and the higher amount for the period between January and the date of the FY 2003 distribution.

HUD Changes to 90 Percent Prediction

When the cut to 70 percent caused a furor among agencies and on Capitol Hill, HUD issued a statement clarifying that it would eventually fund agencies at 90 percent, if Congress provided FY 2003 funds at the level it requested. Congress funded the account at \$3.6 billion less \$250 million for the FY 2002 shortfall. The prorated amount agencies will receive depends now on how much all agencies request in FY 2003.

The FY 2003 Operating Subsidy Shortfall

It appears FY 2003 may also be affected by a shortfall because HUD has not requested sufficient funds. Consider the following:

The FY 2002 appropriation, \$3.48 billion exclusive of set-asides, was at least \$250 million short. A total of at least \$3.73 billion was needed. This does not include any allowance for increases in labor costs, inflation, insurance, utilities, or other budget items that will increase the amount agencies request in FY 2003. A conservative 3 percent increase in these items would necessitate about \$3.9 billion for FY 2003 operating subsidy — about 12 percent more than the FY 2002 appropriation. But the FY 2003 appropriation is \$3.6 billion, less \$250 million for the FY 2002 problem. It appears that the FY 2003 operating fund will be at least \$0.5 billion short of need.

In its FY 2004 budget proposal, HUD requested \$3.574 billion for the operating fund. It appears that this will be insufficient to fund agencies at 100 percent of need.

Public Housing Operating Cost Study (PHOCS)

Finds Low Funding

Harvard University's Graduate School of Design was selected by Congress to conduct a study of the actual cost of operating public housing. The study team's major undertaking was to compare public housing "allowable expense levels²," to the approved budgets for multifamily housing with mortgage subsidies under the Federal Housing Administration. The FHA is part of HUD. The comparison included budgets for more than one million properties, and showed that public housing operating budgets are, on average, 10 percent lower than what HUD considers financially feasible operating budgets in its other, comparable, subsidized properties.

The study team examined costs associated with doing business as a public entity, and the associated rules and regulations of public housing. Although not yet complete, this part of the study appears to show the need for another few percentage points increase over the current funding level for operating subsidy.

Conclusion

We need a renewed commitment to rental housing for very low-income families at both the legislative and bureaucratic levels. The administration's current focus solely on home ownership fails to recognize that many families, especially low-income and minorities targeted for home ownership programs, need to develop stable rental and credit histories as a first step. Public housing can help them do that.

Public housing provides a necessary resource for housing the nation's lowest-income households, including 1 million children and nearly half a million elderly people. To date, the U.S. has invested an estimated \$100 billion in the physical structure of public housing, and at least \$85 billion in operating subsidy. The result is well-run, decent, low-cost housing in rural, suburban and urban communities, serving the poorest families, elderly and disabled people. It is owned and managed by 3,200 local housing agencies, enabled under state laws. It is a common misper-

²The allowable expense level, or AEL, is part of the calculation of an agency's subsidy need. Utilities have a separate calculation, and there are "add-ons," expenses the agency incurs that are not part of the formula. The AEL is calculated by the local housing agency and submitted to HUD, which determines the annual aggregate subsidy eligibility of each agency. Funds are distributed by eligible shares using a formula. For additional information, see <http://www.hud.gov/offices/pih/divisions/ffmd/of/>

ception that agencies are mismanaged. Recently, the General Accounting Office reported only 15 agencies, less than a half-percent, had been placed under receivership for assistance with problems in management and physical condition of properties.

Administration's Proposed Elimination of the HOPE VI Program

NAHRO does not believe that all severely distressed public housing developments have been addressed. Between 1997 and 2001, \$10 billion was requested in 448 applications but only \$2.8 billion (28 percent of requested) was awarded to 98 projects (22 percent of applications). The administration's proposal to eliminate the HOPE VI program in FY 2004 will shortchange communities around the country that could benefit from the considerable resources HOPE VI brings, including housing choice for families at a variety of income levels, and contributions to local economies. There is no other comparable resource for comprehensively addressing the needs of residents living in distressed public housing communities.

HOPE VI performs the dual function of eliminating obsolete public housing and replacing it with mixed-income neighborhood-revitalizing developments. With expenditures of \$3.9 billion since 1993, HOPE VI has also played a key role in supporting the Capital Fund by helping to eliminate a portion of the \$22 billion backlog of capital improvements needs. The program enjoys broad bipartisan support and has proven to be a catalyst that revitalizes neighborhoods and galvanizes local support from private investors and local housing and community development entities.

In 1989, Congress established the Commission on Severely Distressed Public Housing. The Commission undertook a study of public housing and estimated 86,000 units as "severely distressed," or requiring rehab costs of more than 60 percent of the cost to replace the unit. HUD says the HOPE VI program is no longer needed because, between HOPE VI and other demolition programs, it has planned to demolish considerably more than the 86,000 units originally estimated. About 54,000 units were actually demolished under HOPE VI through June 2002, while demolition of another 45,000 was planned.

However, HOPE VI was not intended or designed to be a demolition program. The program provides housing, educational, economic and civic opportunities to residents of low-income public housing developments and surrounding communities, helps increase city tax bases, and provides jobs. Funds budgeted through the HOPE VI program since its inception in 1993, including private-sector investment, totaled \$14 billion through June 2002. Of that amount, \$3.9 billion has been expended, for an additional economic stimulus effect in communities of an estimated \$27 billion over the past 10 years. The overall effect of the program will considerably exceed this if the same rate of investment occurs through the next 10 years.

The Commission's report did not identify specific developments or units that were severely distressed. Without this baseline, it is difficult to determine whether there are more distressed units that could qualify for HOPE VI assistance. However, one indicator is the number of applications for HOPE VI funds that were approvable, but did not receive a grant because of lack of funds. This pool of applications should be examined to determine the number of distressed developments that still would benefit from HOPE VI. In addition, using the criteria developed by the Commission, the remaining public housing stock should be analyzed to determine if additional distressed developments exist.

Because of the cost (\$200,000) and complexity of assembling a HOPE VI application, many communities that need the funds may not have applied, especially among smaller housing agencies in communities where resources are scarcer. The HOPE VI application process demands that local resources, partnerships, and financial commitments are in place at the time of the application; however, smaller communities are more likely to need the HOPE VI grant to help obtain and establish these resources and partnerships.

Conclusion

NAHRO believes the definition of "severe distress" should be modified to enable housing agencies to serve all public housing populations in addition to families; to give equal emphasis to physical and social or community distress, and to reduce the emphasis on, or

requirement for, demolition of public housing. As of 2002, on average only 44 percent of the public housing rental units demolished would be replaced under HOPE VI. NAHRO acknowledges an affordable housing crisis, and believes there is a critical need to develop more rental housing affordable to those below 50 percent of area median income, and especially those below 30 percent.

The program should be recast to provide more local flexibility and more freedom from federal regulation and intervention, which will reduce costs and speed utilization of grant funds. The application process should be redeveloped to address the needs of smaller agencies with fewer resources. A survey of public housing developments should be undertaken to identify the extent and type of need remaining, and the program re-authorized accordingly.

Public Housing Capital Fund

The effectiveness of capital funding in maintaining and improving the \$100 billion public housing portfolio is slowly eroding. Increasingly, HUD and Congress rely on the fund for non-capital expenditures and set-asides, and continue to reduce effective funding amounts.

The Capital Fund is used to pay for capital improvements to public housing properties, such as replacing roofs, heating systems, or windows. It is also used to support agencies' operating budgets, and pays for management improvements to support the built environment. The funds are distributed by formula, based on attributes of the agency's portfolio including age, condition, location, local construction costs, and type of building. Fully 98 percent of housing agencies that receive capital funds obligate and spend the funds within the time limits set in law.³

The capital needs study published by HUD in 1998 shows that the total backlog, or existing modernization need, in public housing is about \$24 billion. Conservatively, over 10 years an investment of at least \$2.4 billion per year would be needed to eliminate the backlog. Another \$2 billion in current needs accumulates each year, for a total annual financial need of at least \$4.4 billion. From FY 1999-2003, roughly \$3 billion per year was appropriated,

³ The FY2002 Capital Fund included a \$550 million set-aside to be shared by agencies that met timely obligation requirements in previous fiscal years. Ninety-eight percent of all Capital Fund recipients received the reward.

Table 2. Set-Asides in the Capital Fund, FY1999-2003

	1999	2000	2001	2002	2003	Total
10-year estimate backlog and accrual¹	\$4.4 b	\$4.4 b	\$4.4 b	\$4.4 b	\$4.4 b	\$22.0 b
HUD Request²	\$3 b	\$2.869 b	\$2.955 b	\$2.293 b	\$2.426 b	\$13.6 b
Enacted Amount^{3,4}	\$3 b	\$2.869 b	\$2.993 b	\$2.843 b	\$2.730 b	\$14.4 b
Demolition	N/A	N/A	N/A	N/A	N/A	
Loan Guarantee	N/A	N/A	N/A	N/A	N/A	
Technical Assistance (statute)	\$100 m	\$75 m	\$50 m	\$51 m	\$51 m	
ROSS	N/A	N/A	N/A	N/A	\$55 m	
Timely expenditure bonus	N/A	N/A	N/A	(\$550 m ²)	(\$447 m ²)	
Emergency reserve (statute)	\$75 m	\$75 m	\$75 m	\$75 m	\$50 m	
Working Capital Fund (IT)	N/A	N/A	\$43 m	\$53 m	\$18.6 m	
Neighborhood Networks	N/A	N/A	N/A	\$15 m	\$15 m	
Lease adjustments Sec. 23 projects	In T/A line item	In T/A line item	In T/A line item	In T/A line item	\$500,000	
Effective Amount³	\$2.825 b	\$2.719 b	\$2.825 b	\$2.649 b	\$2.540 b	\$13.6 b
Percent of 10-year	63%	60%	63%	59%	56%	60%

1 From HUD's budget documents.

2 Of all agencies in 2002 receiving capital funds, 98 percent also received this award, which calls into question the need for such an award.

3 The effective amount is the enacted amount less set-asides. HUD may make additional adjustments to the effective amount before calculating formula amounts.

4 Numbers are actual, not adjusted for inflation.

* For information purposes, HUD's FY2004 budget request is \$2.641 billion, of which \$302 million is set aside, for an effective amount of \$2.339 billion. The set aside amount includes a \$131 million loan guarantee fund.

substantially below the level that would address needs. Accrual needs that are unmet become part of the backlog. In order to stop this cycle and preserve the public housing portfolio as an affordable housing resource, a strong commitment to funding is needed from both HUD and Congress.

The current administration's requests for funding in FY 2001, FY 2002 and FY 2003 were substantially below the \$4.4 billion mark. Congress has increased the funding, but it has not reached the necessary level. Investment in the program since 1999 is \$13.6 billion (effective amount) and \$14.4 billion (enacted amount) compared to the \$22.0 billion level. Overall, the effective amount total is only 60 percent of the investment needed to address backlog and manage accruing costs. Systematic underfunding of the program significantly contributes to housing agencies' difficulties with maintaining quality housing.

If viewed in terms of backlog and accrual, of the \$13.6 billion effective amount, \$10 billion over five years was needed for

accrual, leaving only \$3.6 billion for backlog. This number is improved when HOPE VI funds are considered. HOPE VI grantees expended another \$3.9 billion since 1993 including both HOPE VI and other leveraged funding, which brings the amount available for backlog to \$7.5 billion. However, this still falls short of the 10-year level of backlog funding. The figures also assume stasis in the condition of the public housing stock since 1999 — the number of units neither increased nor decreased and units were not improved or further deteriorated.

Conclusion

As with the HOPE VI program, it is important to periodically assess the public housing inventory to determine the accurate direction and amount of funding needed to maintain the housing stock. This is part of responsible property management, and should be undertaken frequently.⁴ A commitment by the administration to sufficient funding levels will help restore and protect our investment in 1.2 million units of public housing.

Our National Housing Policy

Public housing is a key resource in the nation's response to housing those least able to afford shelter. Among the several programs managed by HUD and other federal agencies, only public housing is affordable to working poor, elderly and disabled persons on fixed incomes who have few other resources on which to rely. The current administration seems to say, through its budget proposals and elimination of programs in housing and community development, that rental housing and other programs for low-income families ought to be dismantled; that the private sector will step in with alternatives to these programs. Over its 70 years in existence, this has not proven true for public housing, nor has there been evidence of very low-income families faring well in private-market housing.

History has shown as a nation we are committed to crafting sound national housing policy for the homeless, those who need safe, decent, and affordable rental housing, including a step toward homeownership for qualified families. At question is whether the current administration is prepared to continue this commitment.

4 HUD conducted studies of its stock in 1985, 1990, 1992 (HOPE VI) and 1998 (Negotiated Rulemaking for the new Capital Fund).



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