Subsidized housing—costs and benefits

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Federal money has been used for more than 40 years to help a growing number of American families obtain better housing than they could otherwise afford. Now, more than 3 million of the country's 76 million households benefit from housing subsidies that total $4 billion a year. Ten years ago, 800,000 households benefited from programs that cost $400 million a year.

Housing subsidies expand as fast as federal funds are made available. Maybe as many as 30 million households—two out of every five—are eligible under existing programs for assistance in meeting housing costs. If fully funded, these programs could cost more than $50 billion a year.

Housing subsidies have been provided under a bewildering variety of programs, most of which are more or less still active. The first major program, authorized in 1937 and still the largest, was low-rent public housing. Rent supplements, loan guaranties, and interest rate subsidies for rental and owner-occupied units have all been tried in various forms.

The fastest growing program today is "Section 8." Under this program, as much as 90 percent of the rent of a high-grade apartment can be paid by the government.

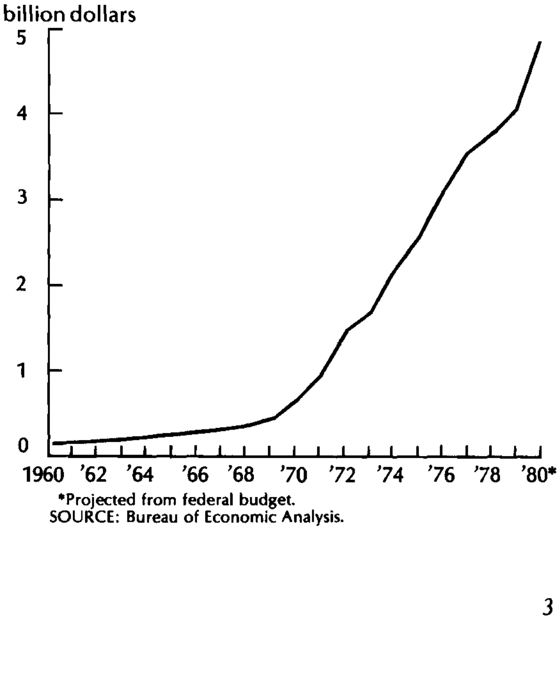
All the housing programs have been attacked at some time or other for high costs and mismanagement. In some areas, units have deteriorated from abuse or neglect to the point that rehabilitation has been impracticable. In other areas, programs have worked reasonably well.

Problems in subsidized housing have brought reforms, modifications to programs, and new approaches. But Congress has continued to cite the objective enunciated in 1949—"a decent home and a suitable living environment for every American family."

Public housing—a noble experiment

More than 1.1 million households are quartered in public housing projects—9,000 of them. The first projects were started in the late 1930s. From 1939 to 1942, some 270,000 units were built. After a lull during the Second World War, when federal attention shifted to defense housing, the program picked up again. New authorizations continued until January 1973, when operating problems brought a moratorium on new public housing projects as well as other subsidized programs beset with similar failings. When authori-

Federal outlays for housing subsidies soar



*Projected from federal budget.
SOURCE: Bureau of Economic Analysis.

zations were resumed in 1974, the public housing program had been scaled down and guidelines had been revised.

Public housing projects are owned and operated by local housing authorities (LHAs) set up by state and local governments. Federal assistance was limited originally to "annual contributions" to pay debt service charges on bonds and notes issued by LHAs to finance construction. These contributions eventually were supplemented by additional subsidies to help cover the costs of operating projects.

Because returns on securities issued by LHAs are exempt from federal income taxes and the securities themselves are guaranteed by the federal government, interest rates on notes and bonds issued by LHAs are low. New issues by groups of housing authorities are periodically offered at auction under HUD auspices. About $14 billion of these securities are now outstanding. The federal government contributes about $1.2 billion a year to service this debt.

Public housing is intended to provide suitable quarters for households too poor to pay the full market cost. Eligibility for public housing is determined by individual LHAs under federal guidelines.

Eligibility in the 1930s was limited to families with incomes no more than five times the rent, including utilities. Income was defined as gross cash receipts, less nonrecurring income, with allowances for the number of people in the family and large medical expenses.

Because rents were expected to cover operating costs, families with very low incomes were generally excluded. As a result, most tenants were the "working poor," households with at least one member employed, but at a low wage.

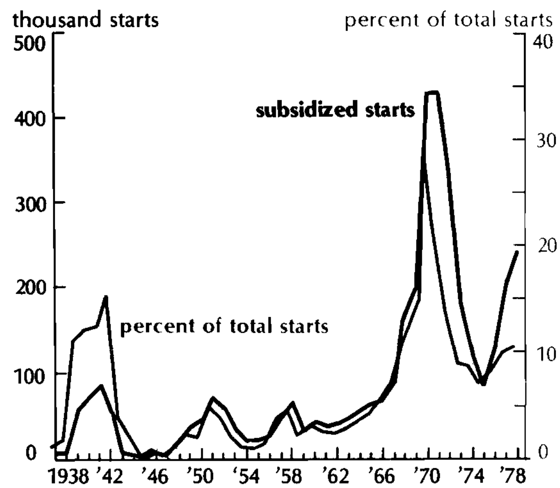
After the Second World War, Congress asserted the principle that public housing should be available to people that could not rent adequate private housing, no matter how low their incomes. With changes in the program made in the 1960s, more and more tenants were elderly, disabled, and chronically unemployed. Many were families headed by welfare mothers.

Problems multiply

The President's Committee on Urban Housing reported in 1968 that millions of families were too poor to pay even the low rents charged for public housing. Many tenants were said to be paying more than half their incomes in rent. To hold down rent increases many local housing authorities were delaying repairs and cutting back on maintenance. As a result, the National Housing Act was amended the next year to provide additional federal subsidies to help meet operating costs of projects, provided LHAs held rents to 25 percent of tenants' incomes. These operating subsidies have risen from $31 million in fiscal 1970 to $280 million in fiscal 1973 and to almost $700 million in 1979.

Meanwhile, tenants in public housing projects have been plagued increasingly with vandalism, assaults, and robberies. Problems have been especially severe in high-rise elevator buildings built on redeveloped land in inner cities. Conditions have become so bad in some projects that vacancies have soared despite the low rents. Some structures have become uninhabitable and been demolished.

New subsidized housing remains well below the level reached in the early 1970s



To ease some of the problems in public housing, several policy changes were made in 1974. Most new projects since then have been smaller, lower, and scattered through more neighborhoods. Some 11,000 of these new units were started in 1978, and 25,000 are due to be started in fiscal 1979.

Basic problems still remain, however. Many buildings are still poorly maintained, overcrowded, and dangerous. Last year, according to HUD, 400 projects were in serious financial trouble. Operating costs—especially fuel, utilities, and maintenance—continued to outrun rents. Public housing seems to have become a permanent part of the housing subsidy picture. Any future expansion, however, is apt to be modest. Emphasis has shifted to subsidizing tenants in buildings privately owned and managed.

Subsidies for home ownership

As problems of public housing became more evident in the 1960s, support grew for other types of subsidies, including programs to encourage home ownership. Problems of inadequate maintenance and vandalism, it was argued, would be reduced if underprivileged families could acquire equity interests in their shelter.

Section 235 of the Housing Act of 1968 inaugurated interest-rate subsidies combined with FHA insurance to help lower income families obtain mortgage loans. Subsidies initially reduced annual interest costs to as little as 1 percent, provided the families used at least 20 percent of their incomes for mortgage amortization payments, insurance, and taxes. They did not include the cost of maintenance and utilities, which were also the responsibility of the owners.

To be eligible for this subsidy, a family could not have an income that was over 35 percent more than the income that would make them eligible for public housing. Downpayments were nominal, as low as $200. This was against the downpayments of 10 to 20 percent required for conventional loans.

Subsidized home ownership under Section 235 was pushed rapidly. From 1968 through 1972, about 400,000 new and existing homes had been purchased under the program. Most of the new owners, however, had no experience with owning real estate, and many had never before lived in a single-family home equipped with modern facilities.

It was apparent by 1972 that the Section 235 program was in trouble. Investigations showed widespread mismanagement and fraud. Many homes, especially older homes that had been rehabilitated, had substantial defects that had been deliberately concealed. Appraisals were often inflated, intentionally or through ignorance. Buyers found themselves with mortgages that substantially exceeded market value of the property and monthly payments that were too heavy. Many houses were not maintained. Some houses were abandoned, as owners with little or no equity interest in their houses took the easy way out from untenable financial arrangements. Left vacant, houses were often vandalized.

New authorizations under Section 235 were suspended in January 1973. But HUD has not given up on the subsidized home ownership program. Section 235 was revised in 1975. And to prevent a recurrence of earlier problems, inspection procedures were tightened, minimum downpayments were raised, and maximum subsidies were reduced.

The upper limit on family income was raised to 95 percent of the area median. To prevent concentration, no more then 40 percent of the houses in a subdivision could be subsidized. Purchases of existing homes could be approved only if they were thoroughly rehabilitated.

About 15,000 single-family homes are expected to be started under Section 235 this year. That will be about twice as many as last year but not nearly as many as supporters of the program would like to see and only a tiny fraction of the number of families eligible for this subsidy.

Several factors other than the limits imposed on the size of the program have limited activity. One is interest rates. The maximum subsidy now reduces effective interest cost to the homeowner to 4 percent, instead of 1 percent, and that is not enough to help many lower-income families. Another is the downpayment. Now 3 percent of the purchase price, the downpayment eliminates some buyers. Most important, however, is the mortgage limit. At $38,000 for a three-bedroom home, even the largest mortgage is not enough to finance many homes that would qualify at current prices.

Section 502 for rural homes

Section 235 had a forerunner in Section 502 of the Housing Act of 1949. Designed to help rural families, Section 502 is administered by the Farmers Home Administration (FmHA). The program provided assistance originally only for isolated farmers, but borrowers in rural towns (not in metropolitan areas) as large as 20,000 can now qualify for FmHA loans.

Under this program, FmHA makes loans directly to homeowners and then sells the mortgages to investors, currently the Federal Financing Bank. FmHA insures and services the loans to low and moderate-income families. Low income is defined as up to $11,200 a year. Moderate is $11,200 to $15,600.

Adjusted from time to time, statutory interest rates are currently 9 percent, which is well below the market rate. Low-income families can receive subsidies called "interest credits" to bring effective interest rates down to as little as 1 percent, the objective, as with Section 235, being to keep housing costs to within 20 percent of income.

Altogether, more than 850,000 loans have been made under Section 502. That is about twice as many as under Section 235. About 20 percent of the Section 502 loans were delinquent in 1978. That is compared with delinquencies of 1 or 2 percent on conventional loans made by S&Ls. (FmHA does not publish information on foreclosure rates.) Despite high delinquencies, the 502 program has not come under the same critical fire as Section 235, however. Along with other subsidy programs, the 502 program was suspended for a while in 1973, but it has since picked up vigorously again.

Aid to private apartments

The federal government has provided rental supplements for almost 15 years to help the poor, elderly, and disabled rent suitable housing units. A major effort was launched through Section 236 of the Housing Act of 1968, providing subsidies for privately owned apartment buildings. More than 400,000 new units have been built under this program, and 50,000 existing units have been rehabilitated.

Subsidies to apartment owners can reduce interest costs to as little as 1 percent. As with Section 235 of the same act, eligibility was restricted to families with adjusted incomes not exceeding the local limits for public housing by more than 35 percent. Subsidized tenants must pay at least 25 percent of their incomes in rent. If rent in a building is more than that, tenants may be eligible for rental subsidies under other programs.

Again as with Section 235, under pressure to get moving with Section 236, officials allowed many irregularities that later plagued the program. Reports have charged inaccurate projections of cost and revenue, shoddy construction, mismanagement, and fraud. And like public housing, 236 projects have suffered vandalism.

More than 100,000 units were started under this program in both 1970 and 1971. Authorizations slowed in 1972, however, as investigations turned up problems. And the general moratorium placed on subsidized housing programs in early 1973 was never lifted from the Section 236 program.

Some 14 percent of the Section 236 mortgages have been foreclosed. And the financial situations of many other projects are reported to be precarious. Most of the failures have been in projects operated by nonprofit organizations or cooperatives, usually without experienced managers in charge. Even when grosser problems have been kept in check, operating costs have continued to rise faster than tenant incomes.

To prevent more failures, large sums have been used from other federal programs to support Section 236 projects. Outlays on these projects in fiscal 1978 totaled about $800 million. That included $600 million under Section 236, $100 million under rent supplements, and $100 million under Section 8.

Section 8—the chosen instrument

The newest, fastest growing federal housing subsidy program is styled Section 8, an amendment to the 1937 Housing Act. Enacted in 1974 after the unsatisfactory results of other programs had been examined at length, Section 8 provides subsidies for tenants in buildings, new or existing, that often are owned and financed privately.

Activity under Section 8 built slowly through 1976, but has since picked up. By the end of 1978, more than 660,000 households were receiving subsidies under this program. Of these, 580,000 were renting previously existing units. In many cases, tenants continued to live in the units they occupied before they were covered by Section 8.

Renters under Section 8 pay no more than 25 percent of their incomes in rent. Certified landlords are paid "fair market rents" determined by annual HUD surveys. HUD pays the subsidy—the difference between tenant payments and the fair market rent—directly to the landlord.

HUD-determined fair market rents are intended to approximate the rent (including utilities) on comparable private apartments. The apartments must be of modest design and meet HUD standards.

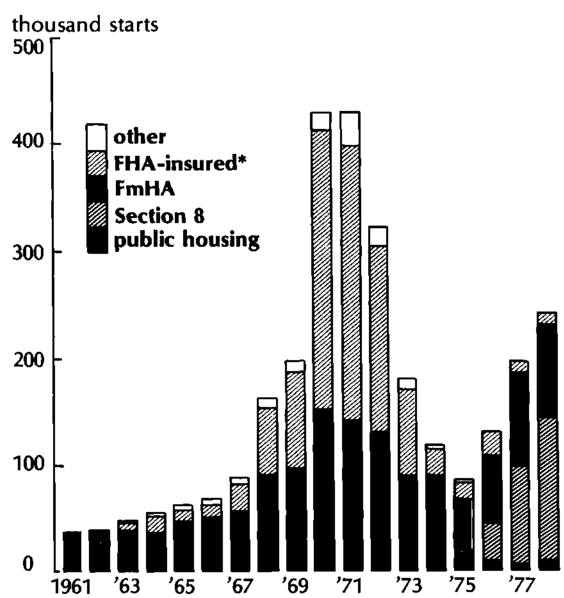
What are considered fair market rents vary with size, location, and age of the apartment. HUD adjusts rent allowances annually to reflect changes in property taxes, insurance premiums, utility costs, maintenance charges, and other operating expenses. The allowable rent for new two-bedroom elevator apartments varied last year from $262 a month in Salt Lake City, to $435 in Chicago, to $631 in San Francisco. The allowance for a four-bedroom unit in New York could be well over $800.

A family may be eligible for Section 8 assistance if its income, adjusted for family size, is no higher than 80 percent of the area median. Theoretically then, 40 percent of the families in an area are eligible for assistance. Thirty percent of the units in new buildings subsidized under Section 8 must be set aside for families with very low incomes. Defined as incomes up to 50 percent of the area median, "very low income" describes a fourth of the families in an area.

Families seeking Section 8 assistance must apply to their local LHA. As the number of families that can be certified is limited by the availability of funds, waiting lists are long. Once certified, however, a family can use its subsidy to lease any apartment in the LHA jurisdiction, provided the rent is no more than what HUD has set as the fair market rent. About half the certificate holders remain in the apartments they were in when they were certified. For these families, the subsidy is equivalent to an unrestricted income supplement.

Unlike previous rent subsidy programs, Section 8 does not limit assistance for building new units to any paricular type of ownership or financing. Section 8 projects can be owned by public agencies or private individuals.

Upswing in subsidized housing starts led by Section 8



*Mainly Section 235 and Section 236 starting in 1969.

Financing can involve tax-exempt bonds issued by state housing finance agencies, below-market federal loans, GNMA tandem securities, or conventional loans with mortgage insurance from either FHA or private insurers.

Of the 300,000 Section 8 units started since 1975, about a third have been financed by state housing finance agencies that can issue tax-exempt bonds and lend the proceeds for Section 8 construction—at below-market rates. Another 50,000 Section 8 starts have received subsidized financing through a Government National Mortgage Association (GNMA) "tandem plan." Under the tandem plan, GNMA buys FHA-insured Section 8 loans made at below-market rates and sells the loans at market yields, absorbing the loss as a subsidy. About 25,000 Section 8 starts have been financed by HUD with Section 202 loans for multifamily housing for the elderly and disabled. The interest rate on Section 202 loans is set slightly above the average yield on outstanding Treasury obligations.

New Section 8 projects take longer to build than comparable private projects. This is because developers have to comply with a variety of government regulations that have much less effect on most private projects. These include environmental impact evaluations, local zoning approvals, federally approved wage scales, equal employment opportunity rules, and HUD minimum property standards. Time spent documenting compliance and waiting for approval adds to construction costs, discouraging some developers from undertaking Section 8 projects.

Operating costs also tend to be higher in Section 8 projects than in private projects. Like public housing projects, Section 8 projects have incurred additional expenses for budget counseling, day-care centers, special facilities for the elderly and handicapped, certification of tenant incomes, and additional maintenance.

To compensate for the extra expense of Section 8 construction and operations, HUD allows the rent in some projects to go up to 20 percent higher than what it has considered fair market rent. Units that are vacant earn subsidies of 80 percent of full rent for up to 60 days. After that, the debt service attributed to a vacant unit can be subsidized for up to a year.

Some developers try to attract investors to proposed Section 8 projects by emphasizing favorable provisions in the tax code relating to the construction of subsidized rental units. Interest and taxes can be written off during construction, and rules for recapturing excess depreciation are not as strict for subsidized buildings as for buildings that are not subsidized.

Some Section 8 problems

Construction and operation of new Section 8 projects involve risks for both HUD and the developers. The determination of fair market rents, for example, is very tricky. These are ceiling rents. If they are too high, there is more potential for waste and abuse. If they are too low, either projects will not be undertaken or operating losses can develop, leading to deferred repairs and maintenance.

Although what was fair as rent may have been properly determined when a project was built, subsequent increases may have been excessive or they may not have been enough to cover the rise in operating costs. Some potential investors in Section 8 projects are afraid the program might fall from favor and that annual increases might be limited or deferred. The results, they fear, could be large deficits and failures, such as those in many public housing and Section 236 projects in the early 1970s.

Subsidies for vacant units are hard to administer. To be eligible for the subsidy, developers must accept any eligible applicants, a requirement that may limit an operator's ability to attract and hold good tenants. A project could attract an influx of undesirable tenants, such as vandals and drug addicts. The operator's prerogatives in evicting undesirable tenants is limited because evictions must be approved by the LHAs.

Questions have been raised about the distribution of Section 8 subsidies.

Subsidized Housing Programs
(1978)

	Housing units occupied	Average annual subsidy	Average annual household income
Rental subsidies			
Public housing	1,173,000	$1,530	$4,640
Rent supplement	172,000	1,370	3,870
Section 236	545,000	1,140	6,330
Section 8			
New construction	85,000	3,000	4,400
Existing housing	581,000	1,340	3,940
Homeownership subsidies			
Section 235			
Original	250,000	350	8,150
Revised	12,000	970	12,330
FmHA Section 502	854,000	n.a.	10,020

Differences in market rents often reflect differences in location, for example, with the result that families in more desirable locations can receive larger subsidies than families with the same income in less desirable locations. Families moving into new apartments can receive larger subsidies than families in used apartments. And subsidized families can be living in more expensive apartments than families that do not receive subsidies—even many middle-income families.

Long waiting lists for eligibility for Section 8 subsidies reflect both the limited funds available for Section 8 and the liberal income standards. Millions of households paying their own way have incomes less than 80 percent of the area median. Provision of funds for expansion of the program to all eligible households would involve enormous cost. Outlays exceeded $800 million in fiscal 1978 and are expected to exceed $1.3 billion in fiscal 1979. But even that will be only a small fraction of potential outlays.

A typical new unit built with Section 8 assistance rented for about $4,000 in 1978. This unit was occupied by a family with an income of about $4,400. The family paid about $90 a month in rent and received a subsidy of $240, or $2,900 a year. In New York, where fair market rents were as high as $800 a month, a family with an income of $4,400 could receive a subsidy of $710, or $8,500 a year.

Under current rules, 40 percent of the country's 76 million households are potentially eligible. If every eligible household received a subsidy of $100 a month, the cost would exceed $35 billion a year. At $200 per month, the cost would be $70 billion. To put these figures in perspective, consumer spending on rent (including the implicit rent on owner-occupied homes) was about $200 billion in 1978.

Subsidies in perspective

Federally provided housing subsidies are just one of many types of income support available for lower-income families—including many families well above the poverty level. These supports consist of subsidies for medical care, food, utility bills, and cash payments that can be spent as the recipient chooses.

Other subsidies available to families of all income groups include, for example, public education and public transportation. As home owners are not required to pay taxes on the imputed rental value of their homes, even the deduction of interest and property taxes for income tax purposes can be viewed as a form of subsidy.

The 40-year record of federal housing subsidies has been marked with great difficulties and many sorry failures. But the principle of decent, affordable housing for all households is firmly entrenched as national policy. These subsidy programs have powerful political support, not only from those that want to help the poor, but also from the building industry, construction unions, promoters, and financial institutions.

Housing subsidies have undoubtedly greatly improved the living standards of many families, with resulting benefits in a healthier, more stable environment. Unfortunately, however, these vast programs, removed from the discipline of the free market, place a heavy strain on the administrators responsible for maintaining equity, integrity, and cost-effectiveness.