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Extended Remarks*

Hearing on Oversight of the HUD Inspection Process

Subcommittee on Housing, Transportation, and Community Development
U.S. Senate Banking, Housing, and Urban Affairs Committee

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What Senators Rubio and Nelson have uncovered is a perfect illustration of what the systematic evidence shows about the performance of the Section 8 New Construction program and other programs that subsidize the construction of privately-owned low-income housing projects. The total cost of providing this housing (that is, what the tenants pay and all the public subsidies) greatly exceeds the market rents of the units provided. The ultimate solution to this problem is to phase out programs of this type.

However, we also need to deal with existing projects to insure that they provide decent housing. The units observed surely did not meet the program's minimum standards, and HUD's monitoring system said that they did. I'll describe the program's incentives for poor maintenance and then talk about what should and should not be done about what Senators Rubio and Nelson have found.

In exchange for substantial subsidies, the developers of privately-owned subsidized housing projects agreed to provide housing meeting certain standards at restricted rents to eligible households for a specified number of years. HUD has a system for monitoring the condition of subsidized housing units. What Senators Rubio and Nelson observed indicates that this system isn't working at all well. They have shown beyond a reasonable doubt that units in a number of projects owned by a particular organization that operates many projects have been in deplorable condition for many years. You should not assume that this problem is limited to this one owner.

It's important to realize that the structure of the project-based Section 8 program incentivizes poor maintenance. When built, the program's units tended to be of reasonable quality because the projects received development subsidies that were proportional to the cost of building them. This provided an incentive to spend a lot on their construction. When new, they were terrific bargains for the tenants. However, the landlords have no incentive to maintain them for many years thereafter, except possibly for dealing with problems like a leaking roof that would severely damage the structure. For a while, the units will be bargains for their tenants and meet

* This document was prepared after hearing the testimony of other witnesses and reading more about what Senators Rubio and Nelson had discovered.

HUD's minimum standards even if they are poorly maintained. The monthly subsidy that owners get from HUD does not depend on the level of maintenance, and it is automatically adjusted upward each year to account for inflation. So owners get the same subsidy in real terms year after year even though the housing provided gets worse and worse. The owners are not legally obligated to spend the subsidy received each month on maintaining the units. With this setup, owners maximize profits by skimping on maintenance.

After years of minimal maintenance, the units will be in such poor condition that the residents with the highest incomes won't be willing to pay the rent necessary to continue to live there. In subsidized housing projects, these tenants pay the highest rent. When they depart, they will be replaced by poorer tenants who pay lower rents. This increases the concentration of the poorest households in the project. It also increases HUD's subsidy because the owner is guaranteed a certain total amount per-unit each month. If tenants pay less, HUD pays more.

Large additional subsidies for the renovation of these projects from the low-income tax credit and other programs restarts the cycle of undermaintenance and excessive profits.

Building expensive new units, maintaining them poorly, and renovating them at great expense a bad way to deliver housing assistance. It is one reason for the excessive cost of subsidized housing projects.

What Senators Rubio and Nelson have uncovered goes beyond this inefficient method for delivering housing assistance. It strikes at the foundation of HUD's primary mission to insure that all citizens live in housing that meets reasonable minimum standards.

As long as the units meet the program's minimum housing standards, the owners have honored their commitment and are legally entitled to receive the promised subsidies. HUD is responsible for the inspection of units in these projects on a regular basis to insure that they meet these standards. If violations are detected, owners are supposed to be given a limited amount of time to correct them. If they fail to do it, HUD is supposed to terminate the contract, stop sending the monthly subsidy to the owner, and provide the tenants with housing vouchers. That did not happen for the projects inspected by Senators Rubio and Nelson because HUD's monitoring system said that the units met the program's minimum standards

If the units visited by Senators Rubio and Nelson do not fall below HUD's minimum standards, the standards themselves should be reconsidered. However, this seems unlikely. These units have been cited for hundreds of local housing code violations over the past three years, and the resident of Eureka Gardens who testified at the hearing stated that these conditions had existed for years before they came to the attention of local code enforcement officials. HUD's annual inspection system should have revealed the failure of these units to meet the program's minimum housing standards years ago. Instead the inspection just prior to Senator Rubio's involvement gave these units a score of 85 out of 100 where a score of at least 60 is needed to meet the standards.

One possible explanation for this outcome is that the inspector did not inspect the units. If an inspector wants to receive a paycheck without inspecting units, he or she must give the units a

score well above passing. Otherwise, the owner will challenge the results. Tenants don't know enough about the program's rules to do that.

Another possible explanation is that the inspector accepted bribes to give the units a high score. Bribing an inspector is often much cheaper than making repairs.

Both of these possibilities should be investigated. The former is grounds for dismissal; the latter for criminal prosecution.

A part of the explanation for what Senators Rubio and Nelson observed might be that HUD is reluctant to enforce minimum housing standards due to its misguided desire to retain subsidized housing projects. Inspectors who failed units would soon learn about any such reluctance. This also motivates the one-for-one replacement rule in public housing's Rental Assistance Demonstration.

This desire is misguided because the evidence indicates that it costs much more to serve low-income households in subsidized projects than with housing vouchers.¹ Phasing out housing projects in favor of housing vouchers would allow us to serve many more households equally well with the same budget.

Contrary to the conventional wisdom, retaining subsidized projects rather than offering their residents portable vouchers restricts the number of affordable units available to assisted households. When HUD fails to terminate contracts due to their owner's failure to provide housing meeting minimum standards or renews a use agreement at the end of its current term, only one unit is made affordable to each household in the project, namely, its current unit. If each household were offered a portable housing voucher, about half of the rental units in the locality would be affordable to it.

Renewing contracts with owners of subsidized projects serves their financial interest. It does not serve the interests of their occupants or taxpayers. So we should disengage from subsidized housing projects at the earliest possible time. We should disengage immediately when landlords fail to provide decent housing within the specified time after a failed inspection. We should have no patience for that. We should not bend over backwards to keep them in the program. We should terminate their contracts promptly and give their tenants portable vouchers.

I believe that Senators Rubio and Nelson have already set in motion everything that needs to be done to deal promptly with the problems in the projects observed and determine whether these are isolated incidents or widespread. Although I doubt that the majority of units in HUD-subsidized privately-owned projects fail to meet HUD's minimum standards, I wouldn't be surprised if a significant minority did. If only 10 percent were similar to Eureka Gardens, more than 100,000 families would be living in deplorable housing at great taxpayer expense.

I hope that the Committee will follow up vigorously on these initiatives. This should include insisting that HUD send a representative to testify about how Eureka Gardens could have passed

¹ Olsen (https://www.brookings.edu/wp-content/uploads/2016/06/0923_housing_olsen.pdf, pp. 9-16) summarizes the evidence.

the inspection and requiring that the GAO study mandated in Rubio Amendment 3926 to HR 2577 be based on a large random sample of projects throughout the country and a random sample of units in those projects. This analysis should compare independent assessments with REAC assessments prior to the legislation. You can safely assume that misbehaving HUD inspectors will be on their best behavior for a while.

What should not be done in response to Senator Rubio's discovery is to provide additional subsidies to the owners of these projects to renovate them. The evidence indicates that this is a highly cost-ineffective method for delivering housing assistance. Indeed, we should go further and not renew the contracts for these projects at the end of their use agreements but instead give their occupants housing vouchers. The evidence indicates that amounts well above-market rents are paid when the government renews use agreements with owners of privately owned subsidized projects. In contrast, market rents are paid for units occupied by voucher recipients. If the owners of the projects are providing good housing for the money, their tenants will want to use their vouchers to remain in their current units. Otherwise, the owners shouldn't be in the business of providing housing.