

Voucher Policy from the Perspective of a Taxpayer Who Wants to Help Low-Income Households

Ed Olsen
Professor of Economics
University of Virginia
Charlottesville, Virginia

Testimony before the House Committee on Financial Services
Subcommittee on Housing and Community Opportunity
June 21, 2001

Madam Chairwoman and members of the Housing and Community Opportunity Subcommittee, I welcome this opportunity to talk with you about housing voucher policy and the role of vouchers in assisting low-income households. I speak from the perspective of a taxpayer who wants to help these households. I have no other financial interests in the matters under consideration at this hearing. My views are influenced not only by this perspective but also by my knowledge of the systematic evidence about the effects of the full range of low-income housing programs. I have been involved in housing policy analysis since the late 1960s. Since then, I have done many empirical studies of the effects of low-income housing programs, and I have read carefully a very large number of other studies. During the Nixon Administration, I was an analyst on the Housing Policy Review Task Force that led to the Section 8 Certificate Program. As a visiting scholar at HUD during the Carter Administration, I worked on an evaluation of this program and reviewed the final reports from the Experimental Housing Allowance Program. More recently, I have written a lengthy survey of what is known about the effects of low-income housing programs for a National Bureau of Economic Research volume on means-tested transfer programs, and I did a substantial amount of work as a consultant to the GAO on their study comparing the cost-effectiveness of tenant-based vouchers and major construction programs such as the Low Income Housing Tax Credit and HOPE VI.

Should Program Features Be Changed to Increase Voucher Usage Rates?

In your invitation to testify, you asked me to address five specific questions related to the ability of public housing authorities to use Section 8 Vouchers.

- What barriers exist in the law, or HUD's implementation of the law, that affect the ability of public housing authorities to make full use of section 8 vouchers?
- How does the policy of determining Fair Market Rents affect the ability of public housing authorities to make full use of section 8 vouchers?
- How does the policy requiring 75% of vouchers to be targeted to individuals with incomes of 30% or below of the local area median affect the ability of public housing authorities to make full use of section 8 vouchers?

- How does the policy limiting a tenant to paying 40% of income for rent affect the ability of public housing authorities to make full use of section 8 vouchers?
- What suggestions do you have to improve the operation of the section 8 program, and specifically to increase utilization of section 8 vouchers?

In discussing these questions, it is important to distinguish between an authority's so-called success rate and its ability to use Section 8 Vouchers. An authority's success rate is the percentage of the households authorized to search for a unit who occupy a unit meeting the program's standards within the housing authority's time limit. Any program rule that reduces the choices available to eligible households will reduce the program's success rate to some extent. Similarly, rules that require authorities to give priority to particular types of households are likely to affect success rates because success rates differ for different types of households.

An authority's success rate bears no necessary relationship to the fraction of the authority's vouchers in use at any point in time. No matter what an authority's success rate, the authority can fully use the vouchers allocated to it by authorizing more households to search for units than the number of vouchers available. For example, if an authority has a success rate of 50 percent, authorizing twice as many households to search as the number of vouchers available will result in full utilization of the vouchers on average. If each housing authority adjusted its issuance of vouchers to its success rate in this manner, some authorities would exceed their budget and others would fall short in a given year. However, the national average success rate would be very close to 100 percent.

For many years, public housing authorities have over-issued vouchers and thereby achieved high usage rates despite low success rates. In recent years, they have had a reserve fund for this purpose, and current regulations call for penalties on authorities with usage rates below 95 percent. My understanding is that the national average usage rate is high (about 92 percent) but some housing authorities are well below the average.

If the perceived problem underlying the questions posed is that housing authorities are not using as much money on vouchers each year as Congress intends, the simplest solution is to increase the number of vouchers authorized. With the given usage rate, this will increase the number of vouchers used. Alternatively, the size of the reserve fund could be increased. This would induce housing authorities to authorize more eligible households to search for units and thereby increase the voucher usage rate. If the variance in usage rates across authorities is perceived as a problem, you might want to consider varying the size of the reserve fund with factors (other than poor program administration) that affect the usage rate.

Changing the policies for determining Fair Market Rents, requiring 75% of vouchers to be targeted to households with extremely low incomes, and limiting tenants to paying no more than 40% of their income on rent will not affect voucher usage rates if housing authorities respond appropriately to these changes. They will, however, affect the program's success rate and hence administrative costs. They will also affect other important aspects of program performance.

Increase Fair Market Rents?

It is only natural for housing authorities to argue for higher Fair Market Rents, especially in their area. With a given number of vouchers allocated to a housing authority, higher Fair Market Rents in a locality allow the housing authorities in that area to provide larger subsidies to their clients at little cost to local taxpayers. Furthermore, higher Fair Market Rents also increase the success rates in the area and hence reduce the work necessary to use a given number of vouchers (Kennedy and Finkel, 1994, pp. 53-60). So assertions that higher Fair Market Rents are necessary to operate the voucher program should be taken with a grain of salt.

The available evidence indicates that Fair Market Rents are considerably higher than necessary to rent units meeting the program's standards. One study examined data from the 1975 American Housing Survey on about 31,000 unsubsidized apartments with 0,1,2,3, and 4+ bedrooms in 13 metropolitan areas (Olsen and Reeder, 1983). In 64 of the 65 cases, the Fair Market Rent exceeded the estimated rent necessary to occupy a unit meeting the program's standards. The excess ranged from 20% to 118%. The median difference over all combinations of metropolitan area and apartment size was 61%. There were noticeable differences in the extent of the excess across metropolitan areas. However, the excess was substantial in all areas. A more recent study used data from the 1989 American Housing Survey on about 10,000 unsubsidized apartments with 1,2, and 3 bedrooms in eleven metropolitan areas (Olsen and Crews, 1996). The results were remarkably similar to those of the earlier study. In all 33 cases, Fair Market Rent exceeded the estimated rent of units just meeting the program's standards. The smallest excess was 22%; the median was 60%. To determine the trend in the gap, the authors applied the same methodology to the six metropolitan areas that were surveyed in 1985, 1989 and 1993. The percentage gap increased enormously over this period. The median of the percentage excess of Fair Market Rent over minimum rent necessary to occupy a unit meeting the program's standards was 33% in 1985, 60% in 1989, and 81% in 1993. Given the many upward exceptions in Fair Market Rents that have been granted in more recent years, there is every reason to expect that the current gap is very large.

Increasing Fair Market Rents would enable current recipients of Section 8 Vouchers to live in better housing and neighborhoods than would be possible with current Fair Market Rents. However, with a fixed program budget, this change would have an extremely unfortunate consequence. It would increase the subsidy per household and hence reduce the number of households served. Since seventy percent of households below the poverty line are not offered housing assistance (Olsen, 2001, pp. 18-19) and more than a million of our poorest households live in seriously inadequate housing, homeless shelters or on the streets, we should not be considering changes in the Section 8 Voucher Program that reduce the number of recipients. Indeed, we should move in the opposite direction, namely decrease Fair Market Rents and use the money saved to serve the poorest unassisted families. If more money becomes available for housing assistance, it should be used to provide additional vouchers rather than larger subsidies to current recipients.

Discontinue Targeting for Extremely Low-Income Households?

In 1998, Congress required housing authorities to target 75% of vouchers to households with extremely low incomes. Four-person households with incomes no greater than 30% of the local median are considered to have extremely low incomes. Income limits for smaller and larger families are obtained by applying nationally uniform percentages to these four-person limits. These income limits are very similar to the official poverty line. This legislation continued a trend in voucher programs begun during the Reagan Administration to focus the limited resources available on the poorest of the poor.

The targeting requirement does not apply to housing authorities whose waiting lists are open and who do not have any extremely low-income households on it. So it does not reduce voucher usage rates for these authorities. Furthermore, existing research suggests that this requirement should increase the program's success rate because success rates in the voucher program are greatest among the poorest households (Kennedy and Finkel, 1994, pp. 53-60). Finally, housing authorities that experience a lower success on account of this targeting requirement can issue more vouchers to maintain the same usage rate. Therefore, there is no reason to weaken the targeting requirement on account of its effect on voucher usage rates. It was a desirable change in policy when it was enacted, and it is still desirable for the same reason. Limited housing assistance resources should be focused on the poorest of the poor.

Eliminate Upper Limit on Tenant Contribution to Rent?

The new Housing Choice Voucher Program places an upper limit on the fraction of adjusted income that a recipient can spend on housing. Effectively, this places an upper limit on the rent of the apartment that the recipient can occupy. This upper limit is greater than the Fair Market Rent (or the Program Standard if that is less) by ten percent of the recipient's adjusted income. Since this provision of the law reduces the choices available to eligible households, it will decrease the success rate to some extent. The existing empirical evidence provides no basis for estimating the magnitude of this effect. However, whatever its magnitude, its effect on the voucher usage rate can be offset by altering the number of vouchers issued. The real issue is whether we should limit the housing consumption of recipients of housing assistance. Why should we deny recipients the opportunity to occupy better housing if it does not involve a greater cost to taxpayers? If there is a good answer to this question, the provision should be retained.

Do We Need a New Production Program?

The most important evidence concerning housing vouchers relates to their role in the system of housing subsidies. Many argue that we should use a mix of vouchers and production programs to deliver housing subsidies to low-income households. Currently, there are calls for a new HUD production program. The systematic evidence on the cost of providing equally desirable housing under different programs lends no support to this view or proposal.

Five major studies have estimated both the cost per unit and the mean market rent of units provided by housing certificates and vouchers and important production programs, namely Public Housing, Section 236, and Section 8 New Construction.¹ These studies are based on data from a wide variety of housing markets and for projects built in many different years. Three were multi-million dollar studies conducted for HUD by respected research firms during the Nixon, Ford, Carter, and Reagan administrations. They are unanimous in finding that housing certificates and vouchers provide equally desirable housing at a much lower total cost than any project-based assistance that has been studied, even though all of these studies are biased in favor of project-based assistance to some extent by the omission of certain indirect costs.

The studies with the most detailed information about the characteristics of the housing provided by the programs found the largest excess costs for the production programs. One study estimated the excessive cost of public housing compared to housing vouchers for providing equally desirable housing to be 64% and 91% in the two cities studied and the excessive cost of Section 236 to be 35% and 75% in these two cities (Mayo and others, 1980). Another study estimated the excessive cost of Section 8 New Construction compared to tenant-based Section 8 Certificates to be 37% even when *all* of the indirect costs of the Section 8 New Construction program are ignored (Wallace and others, 1981). These indirect subsidies include GNMA Tandem Plan interest subsidies for FHA insured projects and the forgone tax revenue due to the tax-exempt status of interest on the bonds used to finance SHFA projects.

Two main objections have been raised to exclusive reliance on tenant-based assistance. Specifically, it has been argued that tenant-based assistance will not work in markets with the lowest vacancy rates and new construction programs have an advantage compared with tenant-based assistance that offsets their cost-ineffectiveness, namely they promote neighborhood revitalization to a much greater extent.

Taken literally, the first argument is clearly incorrect in that Section 8 Certificates and Vouchers have been used continuously in all housing markets for more than two decades. Obviously, it is difficult to keep all vouchers in use at all times due to the inevitable lags between the time that the housing authority receives new vouchers (or old vouchers from households leaving the program) and the time that new recipients find housing that suits them and meets the program's standards. It is also true that some households who are offered vouchers do not find such housing within their housing authority's time limits. However, other eligible households use these vouchers. The overwhelming majority of certificates and vouchers are in use at each point in time. Local housing authorities rarely, if ever, return certificates and vouchers to HUD.

The real issue is not whether tenant-based vouchers can be used in all market conditions but whether it would be better to use new construction or substantial rehabilitation programs in tight markets. In this regard, two questions seem especially important. Will construction programs get eligible households into satisfactory housing faster than tenant-based vouchers in some market conditions? Are construction programs more cost-effective than tenant-based vouchers under some circumstances? Although

¹ The studies are Mayo and others (1980), Olsen and Barton (1983), Schnare and others (1982), U.S. Department of Housing and Urban Development (1974), and Wallace and others (1981). Olsen (2000) provides a description and critical appraisal of the data and methods used in these studies as well as a summary of their results.

careful studies of these two questions have not been done, we can be very confident about the answer to the first question.

Based on existing evidence, there can be little doubt that tenant-based vouchers get households into satisfactory housing much faster than any construction program even in the areas where the highest fraction of vouchers are returned unused. Two major studies of success rates under the tenant-based Section 8 Program have been completed over the past fifteen years (Leger and Kennedy, 1990; Kennedy and Finkel, 1994). These studies collected data on more than 50 local housing authorities selected at random. The lowest success rate observed was 33 percent for New York City in the mid-1980s.² If a housing authority with this success rate issued only the vouchers available at each point in time and allowed recipients up to three months to find a unit meeting the program's standards, about 80 percent of new vouchers would be in use within a year. If they followed the current practice of authorizing more households to search for units than the number of vouchers available, almost all of the vouchers would be in use in much less than a year.

Based on data on a large stratified random sample of 800 projects built between 1975 and 1979, Schnare, Pedone, Moss, and Heintz (1982) found the mean time from application for project approval to completion of the project ranged from 23 months for Section 236 to 53 months for conventional public housing. Mean times ranged from 26 to 31 months for the variants of the Section 8 New Construction and Substantial Rehabilitation Program. Occupancy of the completed units required additional time. Although the authors did not report results separately for different markets, it seems reasonable to believe that these times were greater in the tightest housing markets because the demand for unsubsidized construction would be greatest in these locations. So if Congress were to simultaneously authorize an equal number of tenant-based vouchers and units under any construction program, it is clear that all of the vouchers would be in use long before the first newly built unit was occupied, no matter what the condition of the local housing market at the time that the money is appropriated.

The second major objection to the exclusive reliance on tenant-based assistance is that new construction promotes neighborhood revitalization to a much greater extent than tenant-based assistance. The evidence from the Experimental Housing Allowance Program is that even an entitlement housing voucher program will have modest effects on neighborhoods and the small literature on the Section 8 Voucher Program confirms these findings for a similar non-entitlement program (Lowry, 1993, pp. 205-217; Galster, Tatian, Smith, 1999B). These programs result in the upgrading of many existing dwellings, but this is concentrated on their interiors. It is plausible to believe that a new subsidized project built at low-density in a neighborhood with the worst housing and poorest households would make that neighborhood a more attractive place to live for some years after its construction. The issue is not, however, whether some construction projects lead to neighborhood upgrading. The issues are who benefits from this upgrading, the extent to which upgrading of one neighborhood leads to the deterioration

² The success rate in New York City in the mid-1980s was much lower than the second lowest (47 percent in Boston in the mid-1980s) and much lower than in New York City in 1993 (65 percent). An earlier study based on data from the late 1970s found lower success rates. However, at that time housing authorities were still figuring out how to administer this new program. So these success rates are of no relevance for predicting the effects of expanding the program today.

of other neighborhoods, and the magnitude of neighborhood upgrading across all projects under a program over the life of these projects.

The primary beneficiaries of neighborhood upgrading will be the owners of nearby properties. Since the overwhelming majority of the poorest households are renters, it is plausible to believe that most of the housing surrounding housing projects located in the poorest neighborhoods is rental. Therefore, if a newly built subsidized project makes the neighborhood a more attractive place to live, the owners of this rental housing will charge higher rents and the value of their property will be greater. Since the occupants of this rental housing could have lived in a nicer neighborhood prior to the project by paying a higher rent, they are hurt by its construction. The poor will benefit from the neighborhood upgrading only to the extent that they own the property surrounding the project.

With the passage of time, the initial residents will leave the neighborhood in response to the project and others who value a better neighborhood more highly will replace them. In short, housing programs involving new construction may primarily shift the location of the worst neighborhoods. The aforementioned possibilities have not even been recognized in discussions of housing policy, let alone studied.

What has been studied is the extent to which projects under various housing programs affect neighborhood property values. The existing studies find small positive effects on average for some programs and small negative effects for others (Lee, Culhane, and Wachter, 1999; Galster, Tatian, and Smith, 1999B). No study finds substantial positive effects on average for any program.

We do not need production programs to increase the supply of units meeting minimum housing standards. The Experimental Housing Allowance Program demonstrated without any doubt that the supply can be increased rapidly by upgrading the existing stock of housing even in tight markets (HUD, 1980, pp.43-54). This happened without any rehabilitation grants to suppliers. It happened entirely in response to tenant-based assistance that required households to live in units meeting the program's standards in order to receive the subsidy. Housing vouchers enable us to move eligible households into adequate housing faster than any construction program could hope to achieve under any market conditions. The neighborhood revitalization effects of construction programs are typically small and the benefits accrue primarily to owners of nearby rental housing rather than low-income renters in the area. The available evidence is unanimous in finding that housing certificates and vouchers provide equally desirable housing at a much lower total cost than any project-based assistance that has been studied. The consequence of using these costly methods of delivering housing subsidies has been that several million of the poorest households who could have been provided with adequate housing at an affordable rent with the money appropriated for housing assistance have continued to live in deplorable housing. We should learn from our past mistakes and not heed the call for a new HUD production program.

I appreciate the willingness of members of the Committee to listen to the views of an ordinary taxpayer whose only interest in the matters under consideration is to see that tax revenues are used effectively and efficiently to help low-income households.

References

- Galster, George; Smith, Robin E.; Tatian, Peter A.; and Santiago, Anna M. with Mary Cunningham and Charlene Y. Wilson. *Assessing Property Value Impacts of Dispersed Housing Subsidy Programs: Final Report*. Washington, D.C.: The Urban Institute, May 1999A.
- Galster, George C.; Tatian, Peter; and Smith, Robin. "The Impact of Neighbors Who Use Section 8 Certificates on Property Value." *Housing Policy Debate* 10 (1999B): 879-917.
- Kennedy, Stephen D. and Finkel, Meryl. *Section 8 Rental Voucher and Rental Certificate Utilization Study*. Cambridge, MA: Abt Associates Inc., 1994.
- Leger, Mireille L. and Kennedy, Stephen D. *Final Comprehensive Report of the Freestanding Housing Voucher Demonstration*. Volume 1 & 2. Cambridge, MA: Abt Associates Inc., May 1990.
- Lee, Chang-Moo; Culhane, Dennis P.; and Wachter, Susan M. "The Differential Impacts of Federally Assisted Housing Programs on Nearby Property Values: A Philadelphia Case Study." *Housing Policy Debate* 10 (1999): 75-93.
- Lowry, Ira S. (ed.) *Experimenting With Housing Allowances: The Final Report of the Housing Assistance Supply Experiment*. Cambridge, MA: Oelgeschlager, Gunn & Hain, 1983.
- Mayo, Stephen K.; Mansfield, Shirley; Warner, David; and Zwetchkenbaum, Richard. *Housing Allowances and Other Rental Assistance Programs-A Comparison Based on the Housing Allowance Demand Experiment, Part 2: Costs and Efficiency*. Cambridge, MA: Abt Associates Inc, June 1980.
- Olsen, Edgar O. "The Cost-Effectiveness of Alternative Methods of Delivering Housing Subsidies." Unpublished manuscript, December 2000.
- Olsen, Edgar O. "Housing Programs for Low-Income Households." National Bureau of Economic Research, Working Paper 8208, April 2001.
- Olsen, Edgar O., and Barton, David M. "The Benefits and Costs of Public Housing in New York City." *Journal of Public Economics* 20 (April 1983): 299-332.
- Olsen, Edgar O. and Crews, Amy D. "Are Section 8 Housing Subsidies Too High?" Unpublished manuscript, December 1996.
- Olsen, Edgar O. and Reeder, William. "Misdirected Rental Subsidies." *Journal of Policy Analysis and Management* 2 (Summer 1983): 614-620.

Schnare, Ann; Pedone, Carla; Moss, William; and Heintz, Kathleen. *The Costs of HUD Multifamily Housing Programs: A Comparison of the Development, Financing and Life Cycle Costs of Section 8, Public Housing, and Other Major HUD Programs*. Volume 1 & 2. Cambridge, MA: Urban Systems Research and Engineering, Inc., May 1982.

U.S. Department of Housing and Urban Development. *Housing in the Seventies*. Washington, D.C.: Government Printing Office, 1974.

U.S. Department of Housing and Urban Development. *Experimental Housing Allowance Program: The 1980 Report*. Washington, D.C.: Government Printing Office, February 1980.

Wallace, James E.; Bloom, Susan Philipson; Holshouser, William L.; Mansfield, Shirley; and Weinberg, Daniel H. *Participation and Benefits in the Urban Section 8 Program: New Construction and Existing Housing*. Volume 1 & 2. Cambridge, MA: Abt Associates Inc., January 1981.