

THE URBAN PROSPECT

Housing, Planning and Economic Development in New York

October/November 1997

Volume 3, Number 5

Section 8 Still Simmering

After several years of intense political debate and maneuvering, Congress has enacted legislation aimed at relieving the contract renewal crisis of Section 8 housing.

Despite the cost-containing legislation, however, Section 8 budgets will continue to swell. With tighter limits on federal discretionary spending resulting from the Balanced Budget Act of 1997, new housing development could be crowded out of the federal budget.

In such a fiscal environment many housing professionals are wondering when, and if, Congress will resume funding new rental subsidies. Many feel that demand-side housing subsidies are an essential housing policy tool which only the federal government can provide. Both inside and outside of city government, housing experts have been pondering what kind of program would satisfy the city's dire need for rent subsidies and at the same time be palatable to Congress.

Budget Agreement Sets the Tone

This past summer, the President and Congress negotiated and enacted two pieces of legislation, The Taxpayer Relief Act of 1997 and The Balanced Budget Act of 1997, that together will set the scope of federal budget policy for the next five years.

The Taxpayer Relief Act is expected to reduce federal revenues by about \$95 billion over the next five years. The largest items in the tax reduction legislation include creation of new tuition tax credits and child tax credits, and reductions in the estate tax, the corporate alternative minimum tax, and the capital gains tax. Several new tax breaks are targeted at low-income or urban areas, including an expansion and enhancement of the Empowerment Zone program, incentives aimed at promoting "brownfields" redevelopment, and larger tax subsidies for employers who hire long-term welfare recipients. Those items are expected to cost \$1.2 billion over five years.

On the spending side, The Balanced Budget Act imposes \$160 billion in gross cuts between 1998 and 2002, nearly three-quarters of which will come in the Medicare and Medicaid programs. Those spending reductions are partially offset by a \$20 billion increase for children's health insurance programs and \$13 billion increase for programs intended to mitigate the effects of last year's welfare reform law.

The specific tax code and program changes implemented by the two laws will have a negligible net impact on the overall

budget of the federal government during the next five years. Of far greater importance are the budget-setting rules that were extended or modified by the legislation, which will set the tone for national budget politics during the coming years. Most of those procedural provisions are contained in Title X of the Balanced Budget Act.

With the Budget Enforcement Act of 1990 (BEA), Congress imposed a set of constraints on its own budget decisions. The pay-as-you-go (PAYGO) system was established for direct expenditures, a category of spending that includes entitlements and other statutory programs that are not under the control of appropriations committees. Under PAYGO, new legislation that raises the cost of direct spending programs must be offset by equivalent reductions in other programs or by revenue increases. Spending increases caused by external economic factors do not require offsets. Title X extends the PAYGO rules through 2002.

Discretionary spending is that portion of the federal budget that is under the direct control of Congress's thirteen appropriations subcommittees, and includes programs for which annual appropriations are required. In fiscal 1998 discretionary spending will total about \$550 billion, of which defense spending represents nearly half. The budget of the Department of Housing and Urban Development accounts for about 4.5 percent of total discretionary spending.

The BEA established dollar caps on discretionary budget authority and outlays through fiscal 1995 which were subsequently extended through fiscal 1998. The BEA further requires that if the limits on discretionary spending are exceeded, the excess must be corrected through a proportional reduction in all discretionary program budgets. Since those controls were imposed, the President and Congress have generally abided by them. The Balanced Budget Act extends these discretionary spending rules, revises the caps for 1998 and establishes new ones for the years through 2002.

The new limits provide for a \$3.6 billion increase in nondefense discretionary budget authority in fiscal 1999. In subsequent years separate caps for defense and nondefense spending are not set, but the total is permitted to rise by only \$4.2 billion in fiscal 2000, by \$4.8 billion in fiscal 2001, and by \$9.0 billion in fiscal 2002. All told, assuming a 3 percent inflation rate, annual discretionary budget authority is required

to fall by 7 percent in real dollars between 1998 and 2002. The limits on actual outlays are even tighter.

It is within that constrained budget context that housing and other urban development programs will have to be positioned. As this summer's budget agreement has established the overall fiscal environment for federal policy, a recently enacted appropriations bill for HUD has brought the agency's budget needs into sharper focus.

The \$18 Billion Bubble

On October 27th the President signed legislation appropriating funds for HUD, the VA, NASA, EPA, and several other independent agencies. While increasing HUD's budget by over 30 percent, the legislation also established the parameters of the federal government's "mark-to-market" policy for containing Section 8 contract renewal costs.

For fiscal 1998 HUD was given \$25.5 billion in new budget authority, an increase of about \$6 billion over last year. Funding for most of the agency's major programs was held at last year's levels or increased slightly, including Community Development Block Grants, HOME, public housing modernization and operating subsidies, HOPE VI, homeless assistance grants and housing programs for special needs populations. The huge increase in the agency's budget, however, is almost entirely for renewing expiring Section 8 contracts.

The budget for Section 8 and related programs was increased from \$4.4 billion in fiscal 1997 to almost \$9.4 billion in 1998. Of that total, \$8.2 billion is allocated for use in connection with expiring or terminating Section 8 subsidy contracts (as well as a small amount to fund rent subsidies under the McKinney Homeless Assistance Act). Amendments to Section 8 contracts, necessary because some of the original long-term contracts were initially underfunded, are budgeted for \$850 million. Another \$343 million is for a variety of special circumstances, such as providing rental assistance to families that are to be relocated from FHA-foreclosed properties or who live in projects leaving the Section 8 program.

The Section 8 contract renewal crunch, which was long anticipated and partially deferred, has obviously arrived. In 1996 contracts covering 408,000 units required renewal; in 1997 the number rose to 646,000. In the current fiscal year, HUD projects that contracts covering 1,786,000 apartments will be up for renewal, and the number will rise steadily, reaching 2,740,000 in 2002. The figures include both a growing number of units covered under 15- to 40-year contracts that are now expiring, as well as units covered by one-year contracts that need to be "re-renewed."

According to HUD's estimates, the \$9.2 billion required to renew expiring contracts in fiscal year 1998 will rise to \$13.2 billion next year, and to \$18.1 billion by 2002 (those figures do not factor in the new mark-to-market legislation). Due to the overlapping effect of initial long-term contract expirations and 1-year re-renewals, as well as the varying costs of different Section 8 subsidies, the composition of Section 8 costs will

gradually evolve. In fiscal 1998, for example, tenant-based certificates and vouchers will account for 72 percent of contract renewal costs. Because most of those are on five-year or one-year terms, however, the number requiring renewal will gradually top out, and their cost will fall to 62 percent of the total by 2002. A similar pattern will hold for Loan Management Set-Aside (LMSA) contract costs, which are currently the largest of the project-based budget items. Since

Budget Appropriations for HUD Programs, 1997-1998

<i>Program:</i>	<i>FY1997</i>	<i>FY1998</i>
	<i>(\$ millions)</i>	
Housing Certificate Fund	4,630	9,373
Contract Renewals	3,600	8,180
Amendments	850	850
Relocation	180	343
Public Housing Capital Fund	2,500	2,500
Public Housing Operating Fund	2,900	2,900
HOPE VI	550	550
Community Development Grants	4,600	4,675
HOME	1,400	1,500
Housing for Special Populations	839	839
Homeless Assistance Grants	823	823
All Other	1,208	2,348

Source: House Appropriations Committee

long-term Section 8 New Construction and Substantial Rehabilitation contracts will continue to expire well into the next century, however, the number of such units requiring annual renewal will continue to increase.

If Congress provides funding roughly equivalent to HUD's current budget projections, Section 8 contract renewal costs would rise from 19 percent of HUD's total budget in fiscal 1997 to 50 percent in 2002. During that same period of time HUD's budget would increase by 46 percent while all other discretionary federal spending would grow by about 1 percent.

Damage Control

In its effort to control the spiraling cost of renewing Section 8 contracts, Congress took the unusual step of legislating substantive program reforms through its appropriations process. Tacked on to this year's standard budget authority legislation was a Title V, "The Multifamily Assisted Housing Reform and Affordability Act of 1997."

CITIZENS HOUSING AND PLANNING COUNCIL

50 East 42nd Street Suite 407 New York NY 10017
Please call (212) 286-9211 for membership information.

Officers	Staff
Frances W. Magee, <i>President</i>	Frank Braconi, <i>Executive Director</i>
David A. Gardner, <i>Chairman</i>	Marian Sameth, <i>Associate Director</i>
Sander Lehrer, <i>Secretary</i>	Kristin Morse, <i>Director of Policy Research</i>
Robert Berne, <i>Treasurer</i>	Micah Berul, <i>Staff Associate</i>

**CHPC is a nonprofit, non-partisan membership organization
founded in 1937. Contributions are tax deductible.**

Title V establishes a comprehensive mark-to-market program for restructuring the finances of housing developments with expiring Section 8 subsidy contracts. The program covers all Section 8 New Construction, Substantial Rehabilitation and Moderate Rehabilitation projects, LMSA projects, Section 23 and 101 projects, and projects in the Section 8(b) property disposition program that are financed by a mortgage insured or held by FHA and in which rents, on average, exceed those of comparable unsubsidized properties in the same market area. The restructurings will be voluntary, in the sense that owners who choose not to participate will not have their subsidy contracts renewed, and will thereby opt out of the program.

The legislation creates a new "Office of Multifamily Housing Restructuring" within HUD to administer the program, and requires that the director of that office be appointed by the President, with the advice and consent of the Senate, within 60 days of enactment. Actual responsibility for performing project restructurings will be delegated to public, non-profit or for-profit "participating administrative entities" (PAEs). Priority consideration is to be given to state and local housing finance agencies, who will be given an exclusive time period to determine if they are eligible to participate, and if so HUD is required to select them.

Projects will not be eligible if the owner has engaged in "material adverse financial or managerial actions," which are enumerated in the legislation. An owner who is found ineligible for mortgage restructuring and renewal of a subsidy contract will have 30 days to protest the findings; if the rejection is upheld, low-income tenants of the project will be provided tenant-based rent subsidies (subject to availability through the appropriations process) and procedures will be established to facilitate the voluntary sale of the property as part of a restructuring plan. Tenant organizations and community-based non-profits will be given preference in such transfers.

For projects that are determined to be eligible, renewal of project-based assistance will be mandatory if the PAE determines that there is not sufficient adequate and affordable housing in the area, that the tenants would not be able to use tenant-based assistance successfully, if a predominant number of the units are occupied by elderly or disabled families, or if the project is held by a non-profit cooperative. If the project does not meet the criteria for mandatory project-based assistance, the PAE will be responsible for determining, in consultation with the owner, whether renewal of project-based assistance or conversion to tenant-based assistance is appropriate.

The basic restructuring tool Congress has provided HUD and its PAEs is authority to write down a project's existing first mortgage, or to arrange for a new one, that is sustainable at local market rents. A second mortgage will be provided in an amount equal to the difference between the original first mortgage and the restructured one. The second mortgage will be interest-bearing but non-amortizing; payments will be deferred as long as the first is outstanding, except to the extent that there is excess income remaining after operating ex-

penses, approved deposits to a replacement reserve, and debt service is provided for. In general, the full amount of the subordinate mortgage will be due when the first mortgage is paid in full or terminated, and all or part of it may be forgiven if the project is acquired by a tenant organization, a tenant-endorsed non-profit or a public agency. The legislation permits refinancing of all or part of the debt on a project and authorizes HUD to amend existing mortgage insurance contracts or to provide new FHA mortgage insurance, reinsurance or other credit enhancements. The credit subsidy costs of providing mortgage insurance will not be subject to statutory limitations on appropriations or the number of units.

A principal concern of Section 8 owners has been that they would be subject to accelerated tax liability as a consequence of the mortgage write-down. The Congressional conference committee stated that it believed its restructuring formula would result in favorable tax rulings from the Treasury Department, but urged the committees with jurisdiction over such tax issues to consider legislative changes that would mitigate any adverse tax ramifications.

One of the crucial responsibilities of the PAEs is to determine the appropriate level of rents for each restructured project. The law stipulates that the rents should be set equivalent to those prevailing in at least two comparable projects, and if appropriate comparables are not available, to 90 percent of the fair market rent for the local area. If the PAE determines that the housing needs of the tenants and community cannot be met under those guidelines, budget-based rents can be set at a level sufficient to cover debt service, operating

Rent Subsidy Units Expiring and Estimated Cost of Renewal

** includes 50,000 incremental certificates not funded by Congress.*

Source: Department of Housing and Urban Development

expenses, an allowance for a reasonable rate of return or for operating losses, and other necessary expenses. The budget-based rents may be set at up to 120 percent of the fair market rent. Unless the Secretary of HUD issues a finding of special need, only 20 percent of the contracts expiring in a fiscal year within a PAE's jurisdiction may receive the rent exception.

HUD estimates that the reforms will save \$1.6 billion over the next five years. Housing professionals familiar with Section 8 financing in New York appear to be generally satisfied with the terms of the mark-to-market law. It does not, however, apply to contracts expiring before October 1, 1998. In the meantime, HUD will proceed with its mark-to-market demonstration program, which applies to a more restricted category of expiring contracts. For purposes of implementing the demonstration, HUD has recently selected the New York-based Community Preservation Corporation as a joint venture partner, with responsibilities much like those to be performed by PAEs under the Title V program.

Desperately Seeking Subsidies

The recent Congressional action to conserve on project-based subsidies underscores the precarious status of funding for expiring tenant-based vouchers and certificates. At the same time, the impact of Congress' 1995 termination of funding for new tenant-based subsidies is hitting the housing development community full force.

A recently-published study by CHPC documents the critical role tenant-based certificates and vouchers have played in securing permanent housing for homeless families and facilitating the development of low-income housing (*Paying the Rent: An Evaluation of the Section 8 Existing Housing Program in New York City*, CHPC, October 1997). Moreover, many projects developed during the past ten years were underwritten assuming that there would be a regular flow of tenants with certificates or vouchers to fill vacancies. The need for them arises because families surviving on public assistance—or on minimum wage employment—cannot pay rents sufficient to cover the cost of providing housing.

Between 1990 and 1994 New York City received funding to provide nearly 10,000 additional families with Section 8 subsidies annually. Since then, the city has received virtually no new certificates or vouchers, and has had to make do with the 3,000 or so recaptured from tenants who have died or are no longer eligible. That number is barely large enough to cover the city's minimal needs. The Department of Housing Preservation and Development estimates that it needs between 2,000 and 3,000 to service its pipeline of housing projects previously underwritten assuming Section 8 availability, and that there will be an on-going need of 350 per year to fill vacancies in existing projects. The Department of Homeless Services needs a minimum of 2,500 per year to maintain its rate of homeless family placements. If all the recaptured certificates are used to fill those essential needs, there will be virtually none left to facilitate new housing development and rehabilitation.

Faced with a dire need for rent subsidies, there has been a good deal of discussion in housing circles about what kind of rent subsidy program would be financially and politically realistic. Some have suggested a city-funded program, but others are reluctant to advocate for city assumption of yet another function they feel is rightfully a federal obligation.

Most proposals for a new federal rent subsidy program adopt a block grant approach, in recognition of congressional reluctance to fund any programs involving renewable federal commitments. One such proposal has been incorporated into a house bill that would consolidate federal homeless assistance programs. Formulated by the Corporation for Supported Housing and the National Equity Fund, the provision would allow a portion of federal homeless assistance to be used as a 15-year capitalized rent subsidy in new low-income developments. The groups estimate that the subsidy would cost from \$18,000 to \$25,000 per unit, depending on the region of the country. The approach has appeal because it does not entail an implicit federal commitment to renew or subject housing developers to the vagaries of annual budget politics; its disadvantage is that the front-loaded costs would initially be greater than for annually-renewed certificates.

A common feature of many rent subsidy ideas under discussion is an emphasis on facilitating housing development through cost-based, project-specific subsidies. That could lower costs while sacrificing some of the broader goals of the Section 8 program that proved to be largely illusory. As the recent CHPC study confirmed, Section 8 certificates and vouchers have not successfully promoted racial desegregation or poverty deconcentration.

Many housing policy experts believe that the most promising long-run strategy is to tie the funding of rent subsidies to welfare-to-work initiatives. There is some programmatic evidence that enhanced housing stability, or relocation to areas where low-skilled labor is in short supply, can help to promote employment among dependent individuals and families. But successful programs usually provide intensive support services and thereby cost more. During this budget cycle HUD requested 50,000 vouchers for a welfare-to-work initiative which Congress did not fund, indicating that more convincing evidence and specific planning will be necessary to gain congressional approval.

If an effective welfare-to-work program can be devised, it can also help to increase availability of Section 8 reissues. With 100,000 vouchers and certificates now in use in the city, even a small increase in the turnover rate can have a dramatic impact on the annual supply. Mitigating against faster turnover, however, is the 80 percent of median income eligibility of Section 8, which requires an unlikely degree of income mobility before most recipients lose eligibility. The turnover rate could be increased somewhat by lowering the eligibility limit.

Even if there is no change in the basic turnover rate, however, the gross number of reissues available will gradually increase, as the large population of certificates and vouchers issued during the early 1990s matures. Consequently, some housing professionals stress the importance of preserving localities' right to reissue. Congress has already taken some actions intended to impede the reissue of recaptured certificates and vouchers, and those observers fear that the temptation will increase along with Section 8 contract renewal costs. ■