CBO TESTIMONY

Statement of
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before the
Subcommittee on VA, HUD, and Independent Agencies
Committee on Appropriations
United States Senate

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Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you to discuss the budgetary situation of the federal rental assistance programs operated by the Department of Housing and Urban Development (HUD). My testimony today is based primarily on a study by the Congressional Budget Office (CBO) titled *The Challenges Facing Federal Rental Assistance Programs,* which was released last month.

Appropriation decisions made by the Congress over the last two decades or so have committed the federal government to large future outlays for rental assistance. Moreover, the upcoming expiration of significant numbers of existing commitments will add pressure for additional appropriations. That situation appears at odds with the goals of many Members of Congress to reduce the size of government significantly and to increase spending in certain discretionary areas such as defense.

My statement today discusses three topics:

- The relationship between budget authority and outlays in rental assistance programs in which expenditures resulting from a given year's appropriation occur over long periods of time;

- The conflict between projected spending on rental assistance and the desire of many Members of Congress for a sharp decline in domestic spending; and

- Options for reducing federal expenditures on rental assistance.

BUDGETARY ASPECTS OF FEDERAL RENTAL AID PROGRAMS

The Department of Housing and Urban Development administers the major federal rental assistance programs that provide the bulk of rental aid to households with low incomes. Outlays for those programs amounted to an estimated $22 billion in 1994, or about 9 percent of domestic discretionary spending, and went to about 4.7 million households. But in contrast to federal entitlement programs, rental aid is not provided to all households who qualify for it. Less than a third of eligible households receive aid and many nonrecipients experience significant housing problems.

Rental assistance can be either project based or household based (see Box 1). Both types of aid typically reduce a household's payment for rent to about 30 percent of its income, with the government paying the remainder of the rent. In 1995, the average recipient of household-based aid will receive an estimated $5,400 in housing subsidies. Such a substantial amount of aid means that recipients are considerably better off than their unassisted counterparts.

Box 1.
Types of Rental Housing Assistance

Households receiving federal housing aid are divided into two groups: those that receive project-based subsidies and those that receive household-based subsidies.

Project-Based Subsidies. Households that receive this kind of subsidy must live in certain publicly or privately owned housing projects that have been constructed or rehabilitated under various programs administered by the Department of Housing and Urban Development (HUD). The main programs are the following:

- *Public Housing.* Projects are built with federal funds but are owned and operated by local public housing authorities. Tenants typically pay 30 percent of their income for rent, and the federal government pays the remainder of the costs of operating the project.

- *Section 8 New Construction and Substantial Rehabilitation.* In this program, private entities build and own the projects. The federal government, however, agrees to subsidize rents for periods ranging from 20 to 40 years. Tenants typically pay 30 percent of their income for rent; the federal government pays the remainder.

- *Section 236.* Projects are built and owned by private entities, but the federal government supplies a variety of subsidies, including ones for mortgage interest, to keep rents affordable. Tenants may pay more or less than 30 percent of their income for rent, depending on their income and the particular type of subsidy that the project owner receives.

Household-Based Subsidies. Households that receive these subsidies may live in a unit of their choosing from among the stock of private rental units, provided that the unit meets HUD's standards for quality and occupancy. There are two kinds of household-based subsidies:

- *Section 8 Certificates.* The federal government pays the difference between the unit's actual rent and 30 percent of the tenant's income. Generally, the rent for the unit may not exceed the fair market rent, which is set at roughly the 45th percentile of local rents (adjusted for the number of bedrooms) of units that have turned over in the past two years.

- *Section 8 Vouchers.* The federal government pays the difference between a payment standard that is similar to the fair market rent and 30 percent of the tenant's income. If the actual rent exceeds or is less than the payment standard, the tenant pays the excess or keeps the difference.

The major HUD programs that provide project-based aid are the public housing program and the Section 8 new construction and substantial rehabilitation program. Because of high costs, the Congress has sharply curtailed both of them. Nevertheless, because of the pattern of past funding, most people who receive federal rental aid today live in subsidized projects created by those programs.

Other Section 8 programs provide household-based aid in two forms--certificates and vouchers. One difference between those two forms of aid concerns the specific units that recipients can rent. A recipient of a certificate must generally choose from among units that rent for no more than the so-called fair market rent (FMR)--roughly the 45th percentile of the distribution of local rents of units that have turned over in the past two years. Recipients of vouchers face no such restrictions. Another difference is that recipients of certificates receive no additional monetary benefits from choosing a unit that rents below the FMR. In contrast, recipients of vouchers who choose a unit that rents below, or above, a payment standard (which is similar to the FMR) get to keep, or must pay, the difference between the actual rent and the standard. Since 1983, commitments of new aid have been primarily of the household-based kind.

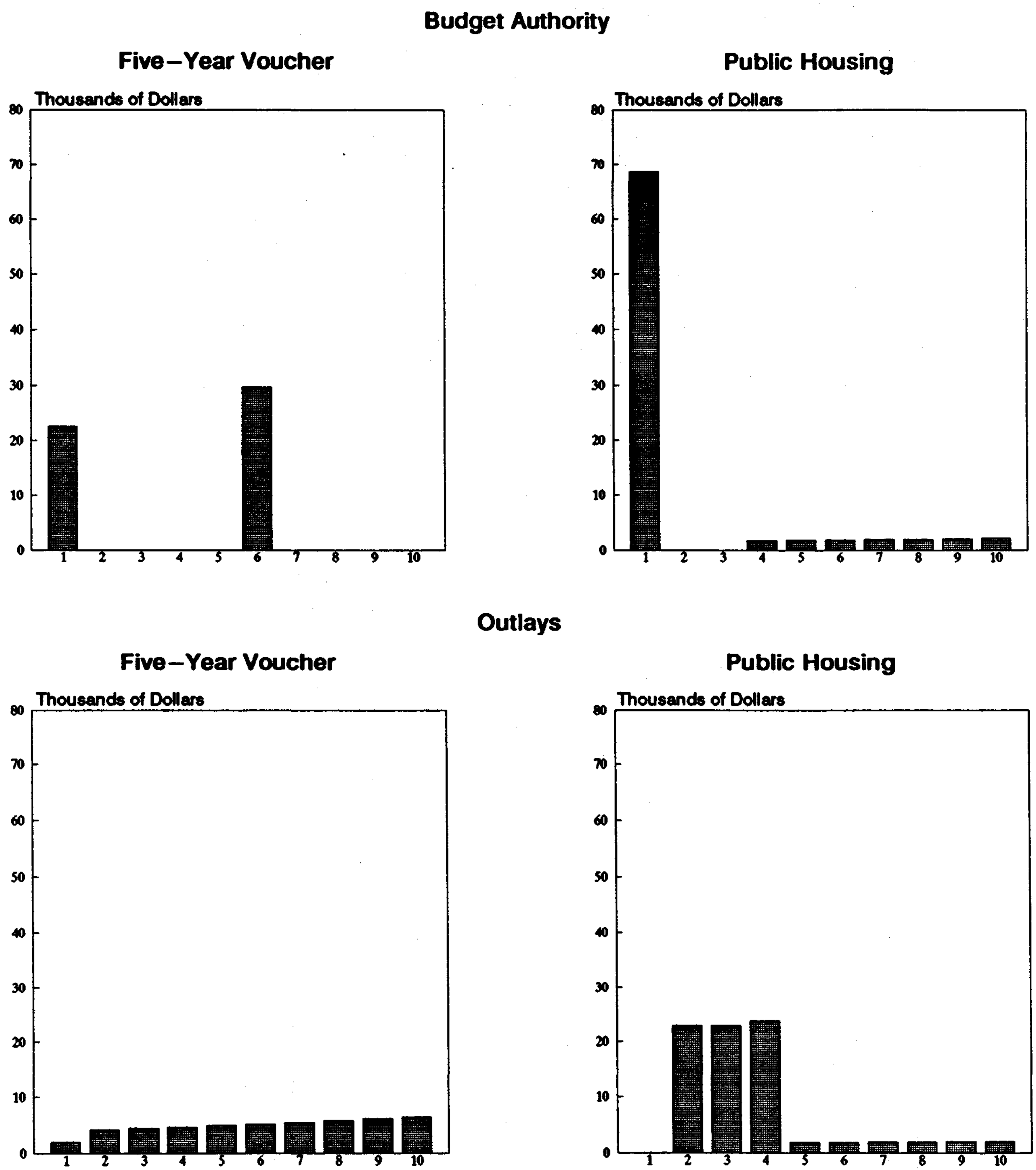
Illustrative Patterns of Budget Authority and Outlays

In past years, the Congress has appropriated budget authority for housing programs for two broad purposes: to fund new commitments that increase the number of assisted households and to support and renew existing commitments of aid. Funds for the first purpose are known as incremental aid; funds for the second are called nonincremental aid. Nonincremental aid extends the life of existing aid commitments, maintains or restores the quality of existing structures, or increases aid to current recipients.

A given year's appropriation of budget authority for housing gives rise to outlays that generally occur over many years. In some housing programs, including all variants of the Section 8 programs, budget authority allows the government to make subsidy payments on behalf of households over periods that today range from three to 20 years. (Before 1983, those periods were as long as 40 years.) When the periods end (that is, when the commitments expire), the aid can only be extended if the Congress appropriates new budget authority. (Figure 1 illustrates those patterns.) Extensions have occurred in some form for all commitments that have expired thus far.

In other housing programs, such as public housing, the Congress appropriates budget authority for grants to entities that construct or rehabilitate assisted rental

Figure 1.
Illustrative Patterns in Budget Authority and Outlays to Provide Housing Aid to One Household for 10 Years Through a Voucher or by Building a Public Housing Unit



SOURCE: Congressional Budget Office.

NOTE: The figure is illustrative only. It is not meant to present the relative costs of the two programs.

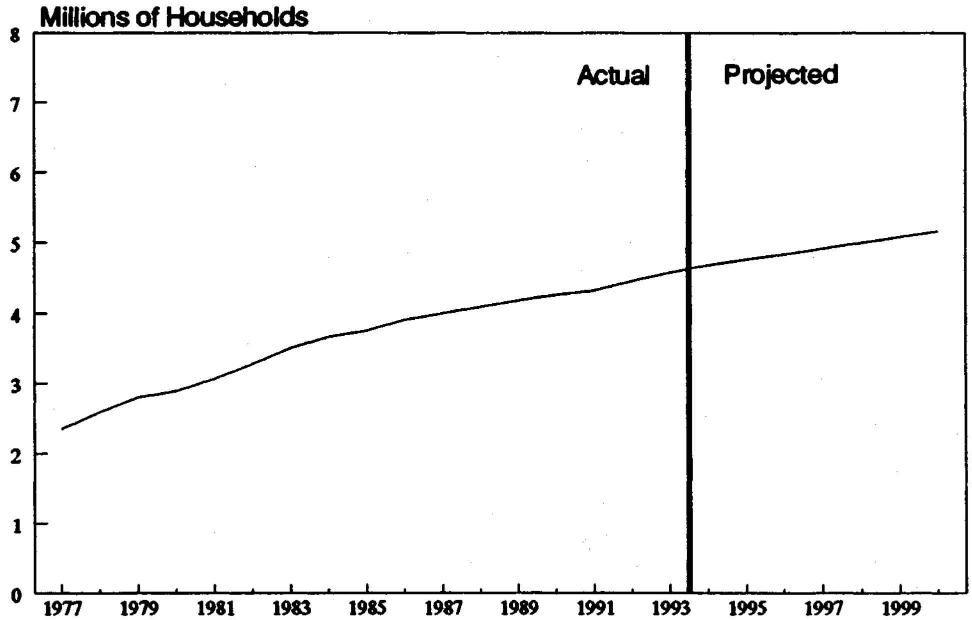
housing. The outlays resulting from those grants also occur over a number of years because of the time required for construction and rehabilitation. After construction is finished, additional expenditures are made each year to help pay for the operating expenses of the projects. In the case of public housing, budget authority for operating subsidies is appropriated for one year at a time (see Figure 1).

Those patterns of long-term spending give rise to a complicated relationship among the total number of assisted households, the outlays that support them, and the budget authority that creates the aid. They also help to explain the apparently contradictory movements since 1977: the number of assisted households and outlays have both grown, while budget authority has declined.

The Rising Numbers of Assisted Households and Outlays

Both the number of households that receive rental aid and the federal outlays for those subsidies have increased in almost every year since 1977. The number of assisted households almost doubled between 1977 and 1994, rising from 2.4 million to 4.7 million (see Figure 2). Growth was generally more rapid during the first half of the period than during the second, however, because lower annual appropriations in the 1980s, among other things, sharply decreased the number of incremental commitments.

Figure 2.
Number of Households Receiving Rental Housing Aid,
End of Fiscal Years 1977–2000



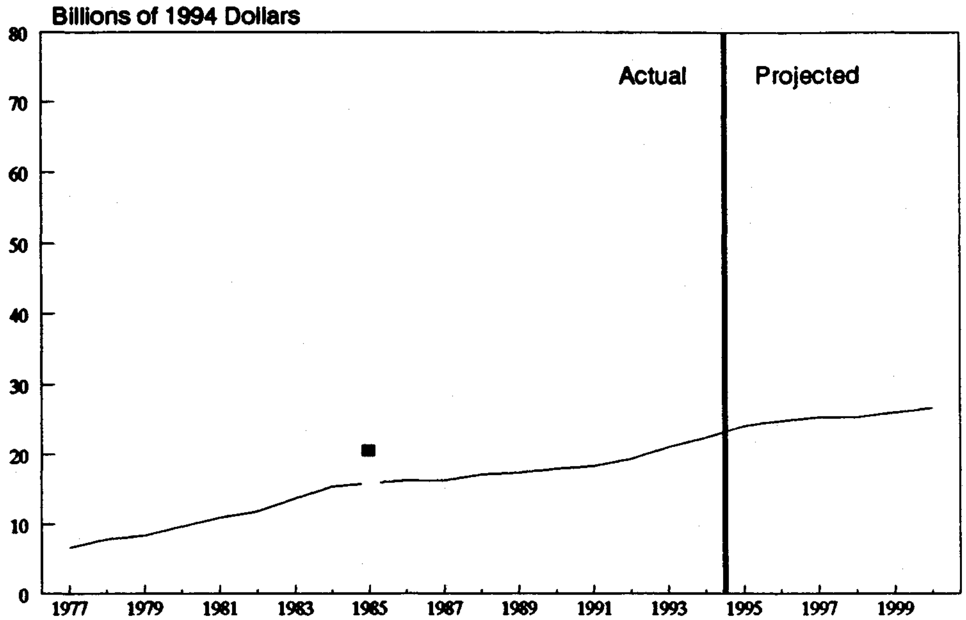
SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

Outlays for rental assistance have also increased steadily since 1977, with the exception of a one-time adjustment that occurred in 1985. In nominal terms, outlays rose almost eightfold, increasing from $2.8 billion in 1977 to more than $22 billion in 1994. After adjusting for inflation, outlays more than tripled during that period, increasing from $6.6 billion (in 1994 dollars) to more than $22 billion (see Figure 3). That relatively rapid growth stems not only from expansions in the number of assisted households but also from several factors that have raised the average real subsidy per assisted household. For example, during the early to mid-1980s, many newly constructed Section 8 units became occupied. Those units, funded from pre-1982 budget authority, required large rental subsidies. In addition, the average rent in assisted units grew faster than the incomes of tenants. That growth pushed up federal subsidies, which typically equal the difference between a unit's rent and 30 percent of the household's income.

The Declining Annual Appropriations of Budget Authority

In contrast to outlays, annual budget authority for housing aid has decreased sharply since the late 1970s, when several new housing programs were first funded. In nominal terms, budget authority fell from $29 billion in 1977 to $9 billion in 1989. Since 1989, however, the trend has changed: budget authority rose to $17 billion in 1991 and has remained fairly flat since then. For 1995, the Congress appropriated

Figure 3.
Real Outlays for Rental Housing Aid, Fiscal Years 1977–2000



SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

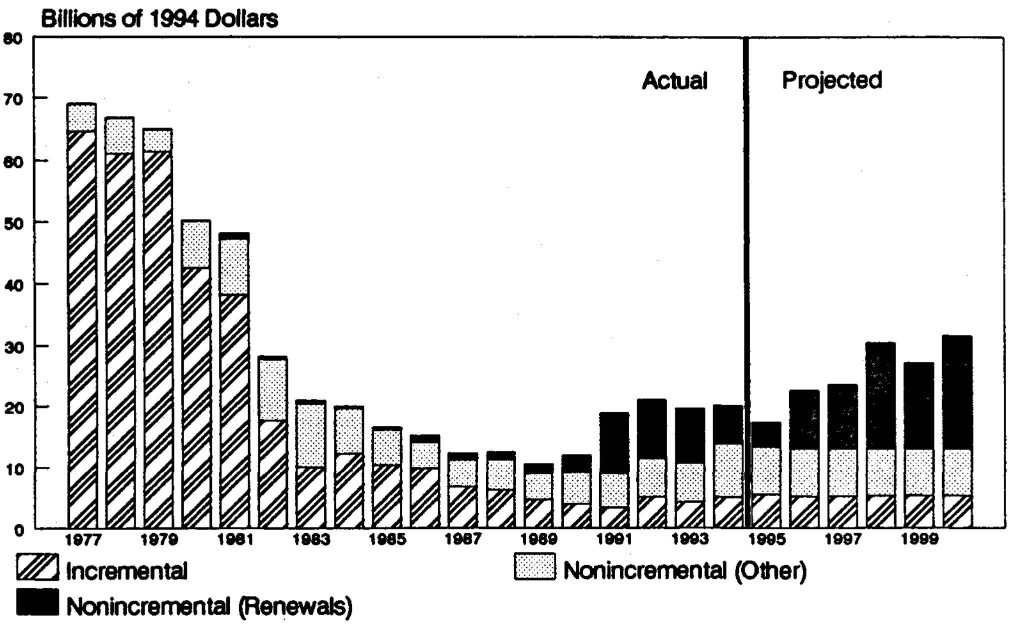
NOTES: Outlays in 1985 were substantially higher because of a change in the method of financing public housing that generated nearly $14 billion in one-time expenditures. Because of those expenditures, outlays for public housing since 1985 have been roughly $1.4 billion (in nominal dollars) lower each year than they would otherwise have been.

Outlays for each year are adjusted for inflation by expressing them in 1994 dollars.

about $17 billion. Real budget authority (in 1994 dollars) fell from $69 billion in 1977 to $10 billion in 1989 before rising again to $19 billion in 1991 (see Figure 4).

As noted earlier, a major component of the decrease in budget authority during the 1980s was the decline in the number of incremental commitments funded each year--from more than 300,000 per year in the late 1970s to fewer than 60,000 in 1990 (see Figure 5). Other components of the decline in budget authority--which did not affect the number of assisted units--included a shift toward much shorter commitments, use of cheaper existing housing rather than more expensive new construction, and, since 1987, changes in the method of financing new construction and modernization programs. For example, reducing the length of commitments made under the Section 8 existing-housing program from 15 to five years decreased by about two-thirds the amount of budget authority needed in the short term to aid a given number of additional households. However, that budget authority must be renewed more frequently because the total resources required over the long term remain unchanged. The increase in budget authority since 1989 results in large part from the substantial amounts that were appropriated to extend expiring commitments.

Figure 4.
Real Budget Authority for Rental Housing Aid, by Type of Aid, Fiscal Years 1977–2000



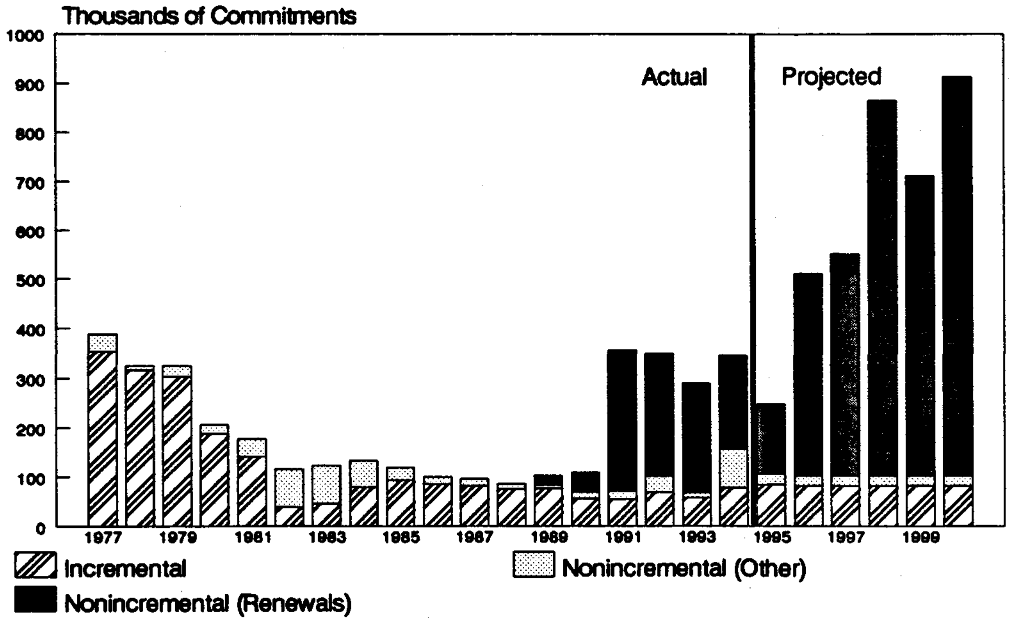
SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTES: Incremental aid increases the number of assisted households. Nonincremental aid for renewals extends the life of current commitments of aid. It includes funding for amending commitments whose funds are exhausted before the end of the term of the commitment. Other nonincremental aid includes, among other things, funding for aid tied to certain units that previously were assisted under a different program and funding for operating subsidies and modernization of public housing.

Outlays for each year are adjusted for inflation by expressing them in 1994 dollars.

Figures for 1994 are estimated.

Figure 5.
Annual Commitments of Rental Housing Aid, by Type, Fiscal Years 1977–2000



SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTES: Commitments for any given year are reduced by the number of housing units for which funds were deobligated, or canceled.

Incremental commitments increase the number of assisted households. Nonincremental commitments of aid for renewals extend the life of current aid commitments. Other nonincremental commitments include aid tied to certain units that previuosly were assisted under a different program.

Figures for 1994 are estimated.

THE CONFLICT BETWEEN SPENDING ON RENTAL AID AND THE GOALS OF SHARPLY REDUCING AND REALLOCATING DISCRETIONARY SPENDING

Spending decisions made by the Congress over about the last 20 years have already committed the government to large future outlays for federal rental aid.

Spending on Rental Aid in Future Years

At the end of fiscal year 1994, the amount of previously appropriated budget authority that had been obligated but not yet spent totaled more than $180 billion. Those funds are scheduled to be spent in future years under the conditions specified in current law.

In addition, many of the housing programs administered by HUD have now reached the point where additional funds must be appropriated if the Congress wants to preserve the number and quality of the rental units in those programs. Budget authority for that nonincremental aid would serve several purposes.

By far the largest amount of budget authority would be for renewing assistance commitments under the Section 8 program. Since 1989, those commitments, which were funded in past years for periods ranging from five to 40

years, have started to expire. To maintain the number of outstanding commitments, the Congress appropriated funds each year between 1989 and 1993 to renew the expiring commitments for five-year terms. The 1994 and 1995 appropriations, however, were about $1.0 billion and $2.6 billion short, respectively, of the amounts requested by the Administration to renew all expiring commitments for five years. As a result, many of those that expired in 1994 were renewed for only four years, and many of those expiring in 1995 will be renewed for three years.

The Omnibus Budget Reconciliation Act of 1990 directs CBO to incorporate the cost of future renewals into its baseline budget projections for housing at an amount equal to the average cost of renewals in the most recent year. Based on the three-year term of the renewals that occurred in 1995, CBO estimates that around $10 billion each year will be needed to renew commitments expiring in 1996 and 1997. Even larger annual amounts--on the order of $16 billion to $21 billion--will be needed for three-year renewals of those expiring in 1998 through 2000. Yet more would be needed in all five years if the Congress chose to extend the commitments for five-year terms.

A significant amount of budget authority will also be needed if the Congress continues to ensure that private entities providing rental units through certain federal housing programs keep their projects available and affordable to households with low incomes rather than convert the units to some alternative use, such as rentals at

market rates. Owners of roughly 400,000 rental units are--or soon will be--eligible to apply for the financial incentives enacted in 1987 and 1990. Under those incentives, owners can raise the rents in their projects, but the federal government will provide subsidies to keep the units affordable to tenants. The additional assistance would come on top of subsidies that the owners already receive, thereby increasing the average subsidy for assisted tenants.

In 1993, HUD estimated that owners of about 132,500 units would apply for those incentives. Consequently, it would need a total of $3.3 billion to fund the first round of five-year incentives as owners became eligible for them. So far, about half of that amount has been appropriated. Renewing those incentive payments when they expire would require additional funds. For example, HUD estimated that the first round of five-year renewals of all of those incentive payments would cost an additional $3.9 billion.

Finally, new budget authority will be needed to operate and repair public housing and other multifamily properties if the Congress wishes to preserve the stock of those units. Public housing alone would require almost $5 billion per year to subsidize operating costs and repairs, in addition to an unfunded backlog of repairs that would cost $10 billion to $20 billion to eliminate.

Caps on Budget Authority and Outlays for Discretionary Programs

The context in which the Congress will determine housing policy for the next few years includes the overall spending caps set by the Balanced Budget and Emergency Deficit Control Act of 1985 (as amended by the Omnibus Budget Reconciliation Acts of 1990 and 1993). Caps in some form have existed since 1991. For 1996 through 1998, separate limitations will exist for budget authority and outlays for all discretionary spending combined (defense, international, and domestic). In 1992 through 1995, appropriators found the outlay caps tougher to meet, and budget authority was therefore billions of dollars under its limits. During the 1996 appropriation cycle, however, that appears unlikely to be the case, as shown in Table 1. In that year, staying within the cap on budget authority would probably lead to outlays being below their cap.

The appropriations debate has thousands of possible outcomes because so many programs are involved. But it is useful to compare the caps with two hypothetical paths for discretionary spending, both of which include the cost of renewing all expiring commitments for three years. For all other discretionary programs, both paths take as their starting point the funds actually appropriated in 1995. The first path would preserve the real resources of those other programs at the 1995 level by assuming that future appropriations grow in step with inflation (about

Table 1.
How Tight Are the Discretionary Caps?
(By fiscal year, in billions of dollars)

	1996	1997	1998
	Budget Authority		
Discretionary Caps[a]	517	527	531
Amount Needed to Preserve 1995 Real Resources			
Amount over or under (-) caps	17	27	50
Amount Needed to Freeze 1995 Dollar Resources			
Amount over or under (-) caps	-1	-10	-6
	Outlays		
Discretionary Caps[a]	549	548	547
Amount Needed to Preserve 1995 Real Resources			
Amount over or under (-) caps	5	26	44
Amount Needed to Freeze 1995 Dollar Resources			
Amount over or under (-) caps	-7	-1	-1

SOURCE: Congressional Budget Office.

NOTE: Amounts needed to preserve 1995 real resources include adjustments for inflation of about 3 percent a year. Amounts needed to freeze 1995 dollar resources include no adjustment for inflation. Both paths include the budget authority necessary to renew expiring contracts for subsidized housing. There are no discretionary caps after 1998.

a. The estimated caps are based on those published in CBO's *Sequestration Preview Report for Fiscal Year 1996.*

3 percent a year). The second path--a "freeze"--would appropriate the same amounts for those programs in future years as in 1995.

Overall, the caps are barely more generous than the freeze on appropriations in 1996 and beyond. A freeze would bring total discretionary budget authority and outlays to just a few billion dollars below the caps--a difference of about $17 billion in budget authority and roughly $9 billion in outlays over the 1996-1998 period.

In contrast, keeping real resources the same (as under the first path) would require total appropriations that exceeded the caps by about $94 billion in budget authority during the 1996-1998 period. Expressed slightly differently, that amount represents the reduction in real resources that is necessary to meet the caps now in place and avoid an across-the-board sequestration of discretionary programs. Moreover, if funding was to be shifted toward defense, less would be available for domestic programs.

If the Congress were to allot to housing programs the amounts of budget authority assumed in the example of a freeze--including the funds necessary for renewals--relatively few changes in past policy would be necessary in the short run. (Table 2 shows budget authority and outlays for housing programs under the two illustrative paths.) The freeze would include sufficient budget authority to extend the expiring commitments for three years. It would also reflect the funding for

Table 2.
Budget Authority and Outlays for Housing Programs Under Two Illustrative Paths, 1995-2000 (By fiscal year, in billion of dollars)

	1995	1996	1997	1998	1999	2000
	Budget Authority					
Renewals[a]	3.3	9.4	10.7	18.9	15.6	21.5
Other						
Preserve Real Resources	14.4[b]	14.8	15.4	15.9	16.4	17.0
"Freeze"	14.4[b]	14.4	14.4	14.4	14.4	14.4
Total						
Preserve Real Resources	17.7[b]	24.3	26.0	34.8	32.0	38.5
"Freeze"	17.7[b]	23.8	25.1	33.2	29.9	35.9
	Outlays					
Preserve Real Resources	24.8	26.4	27.9	29.0	30.7	32.6
"Freeze"	24.8	26.3	27.7	28.6	30.1	31.5

SOURCE: Congressional Budget Office.

NOTE: These amounts were included in the illustrative budget paths shown in Table 1. See text for descriptions of the paths.

a. Budget authority for renewals is the same under both illustrative budget paths.

b. An additional $0.4 billion in budget authority is available because of transfers from other programs and recaptures from earlier appropriations.

incremental commitments made in 1995. By reducing the number of incremental commitments over the next five years, appropriations could be increased for other housing programs--such as operating subsidies for public housing--whose costs rise with inflation.

Nevertheless, the desire of many Members of Congress to reduce the size of government significantly and to reallocate spending may mean that outlays for housing programs would have to be kept well below the levels implied by the example discussed above, where they would rise from $22 billion in 1994 to $31 billion in 2000. In addition, decisionmaking would be further complicated by the numbers of commitments that will expire in 1998 and beyond.

OPTIONS FOR REDUCING FEDERAL RENTAL ASSISTANCE

Although the substantial amount of obligated but unspent funds limits how rapidly outlays could be constrained or reduced, some policy options that would have significant budgetary impacts could be put in place relatively quickly.

Increasing the share of income that tenants pay in rent--from 30 percent to 35 percent, for example--would result in an immediate and substantial reduction in federal outlays, although it would have a much smaller immediate impact on budget

authority. This option could be justified in part based on a finding in CBO's recent study that almost half of very low income households that do not receive housing aid currently pay over half of their income in rent. Thus, even if assisted households paid 35 percent of their income in rent, they would still be significantly better off than their nonassisted counterparts. For the poorest among the assisted households, however, this option could impose considerable hardship. Raising the amount they pay in rent would make it even more difficult for them to purchase other necessities.

Another alternative would be to keep the total number of aid commitments at its current level. This option would reduce outlays relatively little in the short run, compared with continuing the policy of adding incremental commitments each year, but would immediately cut new budget authority for housing aid. It also would not affect any current aid recipients, and turnover among them would make aid available to some new households each year. Over time, however, this option would reduce the proportion of eligible households that were served.

Taking advantage of turnover in household-based programs by not reissuing existing assistance commitments when they are freed up by families leaving the programs would reduce the cost of housing aid even more than the previous option. In fact, if this option was applied to past commitments included in the more than $180 billion of obligated but unspent budget authority, some of the amount originally appropriated for those programs could be rescinded. To that extent, both budget

authority and outlays would be reduced. As with the previous option, this one also has the advantage that it would not affect current recipients. It would, however, cut the number of available aid commitments from the current level and make less use of existing private housing--thereby reversing the direction of recent policy.

Substantial savings could also be achieved in the long run, and some in the next five years, if lower subsidies were offered to owners with expiring Section 8 commitments tied to their projects and to owners who are eligible for incentives to remain in other housing programs. For example, landlords could be offered subsidies that did not exceed the cost of providing vouchers. Tenants in projects whose owners chose to leave the programs could then be given vouchers. But some affected tenants would have to move as a result of this option, and some of them might have difficulty finding existing housing units whose rents did not exceed HUD's rental guidelines.

Other changes would be quite disruptive if carried out quickly. Simply cutting off aid to current recipients, for example, would significantly raise their costs of housing, leaving many of them unable to pay for their present units and facing displacement or eviction.

Instead, such major policy shifts could be announced well in advance of their implementation, thereby allowing affected parties more time to adjust. For example, if a decision not to renew certain household-based commitments was announced in

advance, it would allow current tenants the remaining terms of those commitments to plan as best they could for their loss of aid. Similarly, if a decision was made to limit the amount of time that all assisted tenants could receive housing aid--as has been proposed for welfare programs more generally--tenants who are affected would have that specified time period in which to make plans for the future. One difficulty with both of those options, however, is that some--and perhaps many--of the affected tenants would be unable to make satisfactory arrangements even if they received advance notice. Elderly and disabled tenants, in particular, would probably have little ability to adjust or respond, even if the changes were phased in over several years.

A variety of other factors could also complicate efforts to reduce spending on housing aid. For example, if one housing program provides mortgage insurance for an assisted project and another provides rental assistance, cutting the rental aid might lead owners of some assisted projects to default on their insured mortgage. That increase in cost to the mortgage insurance program would offset at least part of the savings from reducing the rental assistance. Similarly, not making repairs to assisted projects could lead to the loss of the affected units altogether and to the displacement of current tenants.

Thus, the budgetary realities facing federal rental assistance programs are sobering, especially in the context of heightened competition for funds among most areas of federal spending. The challenge facing housing policymakers is always to

make the best possible use of the resources that are available. But if that amount is substantially less than what is required to continue past policies, a number of difficult decisions will have to be made.