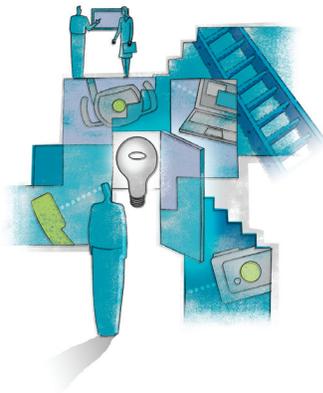


Getting More from Low-Income Housing Assistance



HOUSING SUBSIDIES CONSTITUTE ONE OF THE LARGEST PARTS of government support for low-income people, easily outpacing high-profile programs such as food stamps and temporary assistance to needy families. In total, federal, state, and local governments spend roughly \$50 billion a year on low-income housing programs. Despite this large sum, the current system falls short, failing to provide housing for some who need it and providing inadequate housing for many others.

Edgar O. Olsen, an economist at the University of Virginia, proposes using existing funds more efficiently to address at least partly the system's current shortcomings. In a paper for The Hamilton Project, Olsen proposes shifting from unit-based assistance—subsidizing rental units in particular buildings—to tenant-based assistance, whereby qualifying families would receive housing vouchers that they could apply toward any rental housing unit meeting federal housing standards. According to Olsen, evidence indicates that expanding tenant-based assistance would provide equally good housing at a lower cost compared with the current system, allowing the federal government to serve more families while offering families more choice about where to live. Olsen also proposes making housing assistance an entitlement program, thereby avoiding the inequity he identifies in the current system of providing assistance to some households and denying it to other similar households. Such reforms, he argues, would enable the government to provide housing assistance more fairly and efficiently.

THE CHALLENGE

The goal of housing assistance, according to the Housing Act of 1949, is to provide “a decent home and suitable living environment for every American family.” But low-income housing programs do not, in fact, offer assistance to every needy family. Many families with extremely low incomes put their names on long waiting lists for subsidized housing and then wait until an apartment opens up or a voucher becomes available. As a result, millions of the poorest families go without any housing assistance whatsoever while other families with the same income and composition benefit from large subsidies. And because most families must accept the particular unit offered in order to receive assistance (and loses the subsidy if it moves), they have limited choice about where to live. Thus, even if they are fortunate enough to receive housing assistance, these families cannot choose units that fit their own needs and characteristics.

According to many critics, current housing assistance is not only arbitrary but is also not cost effective. Seventy percent of rental housing assistance in the United States occurs through “unit-based” assistance, in which the subsidy is attached to a particular housing unit rather than being given directly to a family. Public housing, owned and operated by local housing authorities, is the most traditional form of unit-based assistance. Most public housing units were built specifically for the program and receive substantial operating and modernization subsidies from the federal government. In addition to public housing, the federal government also contracts with private housing companies or nonprofits to provide unit-based assistance in subsidized housing projects. The companies agree to provide rental units meeting federal standards to low-income households in exchange for federal subsidies. Altogether, public housing and private subsidized housing provide affordable housing to about 5 million families in the United States.

Olsen argues that unit-based assistance has a number

of drawbacks compared with tenant-based assistance, which constitutes the remaining 30 percent of the low-income housing budget. Under tenant-based assistance the family receives a housing voucher that it can apply to any rental unit meeting minimum federal standards. According to Olsen, unit-based housing needlessly restricts household choice of where to live since families must either live in the unit assigned to them or give up their housing assistance. Unit-based housing may also restrict economic integration and lead participants to live in neighborhoods with high concentrations of poverty. According to a 1997 study, 37 percent of public housing tenants lived in census tracts with poverty rates greater than 40 percent, compared with only 5 percent of voucher recipients living in areas with equally high poverty concentrations.

Evidence also suggests that unit-based assistance is more expensive than tenant-based assistance but does not provide a higher quality of housing. One study found that public housing costs 64 to 91 percent more than voucher programs for housing with the same market rent, while another found a range of 44 to 78 percent more for HUD’s largest program of private subsidized projects.

Olsen largely credits market forces for the greater cost-effectiveness of tenant-based housing assistance. According to Olsen, housing vouchers force landlords to compete for business, so only suppliers who provide acceptable housing at the lowest cost can remain in the program. For example, if a property owner attempts to charge a voucher recipient a rent in excess of the market rent, the tenant will not remain in the unit indefinitely because she can move to a comparable unit at the market rate. By contrast, Olsen argues, under the unit-based system the civil servants who operate public housing projects may not have the financial incentives to keep costs down or improve the quality of services. At the same time, market forces alone may not meet the needs of all voucher holders. This is a concern that Olsen addresses, as discussed further below.

A NEW APPROACH

Currently, tenant-based assistance makes up roughly 30 percent of rental housing assistance and assists 2 million households, far fewer than unit-based assistance. But Olsen believes the evidence on tenant-based assistance shows that it provides equally good housing at a lower cost than unit-based assistance. Given the cost effectiveness of tenant-based assistance, Olsen estimates that shifting toward this approach would allow the government to serve at least 1 million more low-income families. In addition, tenant-based assistance would allow families to choose housing that better suits their needs. The ability to choose where to live would also promote economic integration, Olsen argues, as evidence shows that voucher recipients are far less likely than public housing tenants to live in high poverty areas. Olsen proposes gradually phasing out public housing and private subsidized projects in favor of tenant-based assistance.

Transitioning to Tenant-Based Assistance

Olsen offers a number of steps to move the country from housing programs that rely heavily on unit-based assistance to those that provide housing subsidies directly to tenants in the form of vouchers. First, Olsen proposes a demonstration project that shifts money from operation and modernization subsidies for public housing projects, which make up about one-seventh of the government's low-income housing budget, to tenant-based vouchers. Although current voucher programs offer some lessons, Olsen recognizes that a complete transition to vouchers will involve complexity and uncertainty. Starting with a demonstration project would produce evidence on the effects of this long-term reform, allow policymakers to avoid unforeseen negative consequences, and improve the results of a future nationwide program. The demonstration program would involve public

Millions of the poorest families go without any housing assistance whatsoever while other families with the same income and composition benefit from large subsidies.

housing authorities willing to implement these proposals for a randomly selected subset of their public housing projects. The participating local housing authority would be required to offer a housing voucher to each family currently living in a public housing project. Tenants would be free to apply the voucher toward rent at a housing unit of their choice or to stay in their current unit. Olsen notes that such a reform would not lead to an immediate exodus from public housing: evidence indicates that more than half of public housing tenants would choose to stay, at least initially.

In a nationwide program, housing agencies would be allowed to sell any of their projects to the highest bidder, though they would not be required to do so. Olsen argues that the worst projects would be the most likely to be sold since more of their tenants would accept vouchers. In this way, these distressed projects—which past congressional action has sometimes tried to demolish—would be either improved by private developers or put to better use. Tenants who want to stay in a project that is set to be sold would be made worse off. Olsen offers some possible solutions to this problem, including requiring that a certain percentage of tenants approve the sale or allowing individual buildings in a project to be retained so that tenants can move to those buildings. But while some tenants may be made worse off, Olsen emphasizes that many more will gain a choice about where to live, improving the quality of life for their families.

Key Highlights

The Challenge

The current system of low-income housing assistance has two major flaws, in Olsen's view. First, it relies excessively on unit-based housing assistance, in which recipients must live in public housing projects or private subsidized projects. Unit-based assistance drives up the cost of providing housing assistance, denies families choice in the type of housing they receive, and results in a high concentration of poverty. Second, the current system is highly arbitrary, providing large subsidies to some families while excluding other families with similar needs and composition.

A New Approach

Olsen proposes transitioning from unit-based housing assistance to tenant-based housing assistance, in which families receive a housing voucher that they can apply to any unit that meets minimum federal standards. Under this proposal, the government would phase out public housing by offering all public housing tenants the choice between staying in place or moving to a unit of their choice with a voucher subsidy. Residents of private subsidized projects would be given a similar opportunity to use vouchers. Olsen anticipates that the transition to tenant-based assistance would have the following effects:

- **Improve the cost-effectiveness of housing assistance,** allowing the government to serve at least 1 million more families with the same budget
- **Allow families to choose housing more appropriate** to their tastes and circumstances
- **Increase economic integration in urban areas** and reduce the concentration of poverty

Olsen would also make housing an entitlement, ending the current arbitrary system of assistance in favor of subsidies for all families in need. Olsen anticipates that this reform would reach the poorest of the poor, helping to reduce extreme poverty and homelessness.

The second step Olsen would take in the transition to tenant-based assistance is allowing contracts with private subsidized projects to expire. Private subsidized housing constitutes about three-fourths of unit-based subsidies. Under Olsen's proposal, the government would offer tenants of these privately developed projects portable vouchers, giving tenants the choice about where to live and forcing private projects to compete for their business. Olsen argues that this shift away from private subsidized projects would save money because private housing projects today tend to receive subsidies in excess of market rents.

Finally, Olsen would increase voucher funding by redirecting funds for programs that subsidize construction of new public housing units, such as HUD's HOPE VI and the low-income housing tax credit. Olsen cites evidence from the GAO suggesting that money currently spent on tax credits could be better spent as vouchers, though he acknowledges that further analysis of the cost-effectiveness of the tax credit program is needed. Rather than building new units, he would rely on the housing market to respond to the demand for low-income housing from the many households that would now have vouchers to spend on rent. Olsen provides evidence to support his view that this will provide sufficient incentive to landlords to bring substandard housing units up to federal standards to make their units eligible to participate in the voucher program. Moreover, Olsen argues that rehabilitation of existing housing is a more efficient means of increasing the supply of adequate housing than is new construction. Olsen acknowledges the positive effects of the HOPE VI program, which has generated more attractive, less crowded and less troubled housing projects than those they replaced. He argues, however, that the same beneficial results could be achieved at lower cost through other uses of those federal funds.

Housing as an Entitlement

Olsen would also make housing assistance an entitlement so that any family below a certain income would be eligible for assistance. Creating an entitlement would end the inequities in the current system, Olsen argues, whereby millions of poor families receive no assistance while other, equally poor families receive large subsidies. This disparity is not for lack of interest in receiving assistance; Olsen notes that waiting lists for public housing and housing vouchers are long and would be even longer if they were open continuously for new applicants. Olsen would continue the current method of “means testing” housing assistance so that the amount of assistance is contingent on family income, helping to target assistance to the poorest of the poor.

To say that housing assistance should be an entitlement, however, is not to say that all families will participate. Olsen observes that participation rates in entitlement programs are inevitably less than 100 percent. That is especially true in the case of housing programs, he claims. Enrolling in a housing assistance program involves participation costs—applying for assistance, filling out paperwork, and often moving. These costs would discourage some from participating, particularly those with incomes just below the eligibility limit who would receive only small subsidies. Olsen estimates that the transition from today’s unit-based housing subsidies to a well-funded entitlement voucher program would serve 5.8 million households, compared with 3.4 million currently assisted by HUD programs—roughly a 70 percent increase. Given that about 13 million families would be eligible under an entitlement program, the participation rate would be around 44 percent, which is lower than other welfare programs largely because of the participation costs involved. The amount of funding required would likely exceed current funding, as discussed below.

One study found that 37 percent of public housing project tenants live in areas with very high concentrations of poverty, compared with just 5 percent of voucher recipients.

Questions and Concerns

A shift to tenant-based rather than unit-based rental assistance raises several concerns. Some concerns focus on the cost of these proposals while others focus on whether vouchers would be able to serve all populations in all market conditions.

If vouchers replace unit-based assistance, how do we know the private sector will respond with enough housing at affordable prices?

Responding to this important concern, Olsen reviews the evidence and concludes that the private sector reacts to provide adequate affordable housing to meet new demand created by vouchers. For example, in one random sample study of thirty-three public housing authorities, data were collected about how families with vouchers found homes. About one-third of the voucher recipients stayed in the apartments they occupied prior to participating in the program, almost half of which were repaired in order to meet federal standards. The other two-thirds of voucher recipients moved to new units. Half of the new units were repaired to meet federal standards. Olsen claims that this study and others he reviews show that the private sector not only can provide an adequate quantity of housing at affordable prices to meet demand created by vouchers, but that it is willing and able to improve the quality of its offerings to meet federal standards and attract tenants with vouchers.

Evidence shows that the private sector responds to government vouchers by expanding the supply and increasing the quality of affordable housing.

Will these market reforms adversely affect groups such as large families, the elderly, and persons with disabilities?

According to Olsen, current voucher programs serve many large families, elderly individuals, and persons with disabilities. About one-fourth of families in voucher programs today have at least four members, and almost half have either an elderly member or a member with a disability. It is true that vouchers serve fewer elderly individuals, probably because many housing projects have been built specifically for the elderly, but vouchers actually serve persons with disabilities and large families to a greater extent than do housing projects.

Some critics are concerned that portable vouchers could end up dispersing the elderly and persons with disabilities throughout cities, making it harder to provide services to these individuals. This legitimate concern, responds Olsen, can be overcome through proper design of the voucher program. Medicaid, for example, offers subsidies to low-income people that they can use to live in a nursing home that meets the program's standards. In response to demand created by this program, private firms and nonprofits have built nursing homes that meet Medicaid standards and attract recipients. Similarly, the housing voucher program could offer more generous subsidies to the elderly or persons with disabilities who choose to live in buildings that provide special services. In Olsen's view, this subsidy would likely create an incentive for certain apartment buildings to improve accessibility and provide these services.

Would a tenant-based housing assistance program work in tight housing markets?

Some critics are concerned that a voucher program would not work well in markets with low vacancy rates—in other words, markets in which the vast majority of low-rent housing units are already occupied. Olsen responds that the number of vacant units need not equal the number of new vouchers in the market. Many families already live in housing that meets federal standards and could use their new vouchers without moving. For other families, housing providers would want to attract voucher holders to their properties by bringing substandard dwellings up to par. Olsen cites several studies that he claims offer evidence that tenant-based vouchers increase the supply of units meeting housing standards even in tight housing markets.

To be sure, some families who are offered vouchers are unable to find housing that suits them and meets the program's standards within their housing authority's time limits. But Olsen argues that difficulty in finding housing in tight markets is equally true for families who do not receive vouchers and instead wait to be chosen from a waiting list. For Olsen, the real question is how vouchers compare to unit-based housing projects in tight markets. Evidence from the GAO indicates that vouchers are more cost-effective even in tight markets than are new construction or rehabilitation programs. Olsen also argues that vouchers move families into housing faster than housing projects since local housing authorities can increase the number of available vouchers far more quickly than they can produce more housing.

Would making housing an entitlement program be too expensive or result in an inadequate voucher for those seeking housing?

Several million new households would likely participate if housing assistance were made an entitlement program. Olsen argues that cost savings

from switching from unit-based assistance to tenant-based assistance could cover at least 1 million of these households. To fully cover the rest at current subsidy levels would require new money, although Olsen does not estimate how much. Alternatively, the current budget could cover the entire program through some combination of reducing the fraction of the population eligible for subsidies and reducing the generosity of the voucher.

CONCLUSION

Given the many competing demands on the federal budget, expanding the availability of low-income housing may necessitate reforms that use current spending more wisely to serve a larger number of recipients with equally good housing. According to Olsen, the current unit-based form of low-income housing assistance falls short in that regard. In his view, transferring to a voucher-based system would allow the government to serve many more low-income families for the same cost by leveraging market forces. Moreover, such a program would provide individuals with choice about where to live and what units were most attractive and suitable.

Olsen acknowledges that market forces are not a panacea for the ills of low-income housing. Making housing assistance available to all could reduce the amount available to the poorest families, and dispersing tenants with special needs could hinder access to these services. But these obstacles, Olsen argues, can be overcome with proper design of a voucher program. Vouchers would still be income-tested, for example, and vouchers of greater value could be offered to elderly individuals and persons with disabilities who live in buildings with special services. Compared to the current system, Olsen argues, a tenant-based assistance program can be fashioned that serves more people, offers more choices, and opens more opportunities for low-income families.

Learn More About This Proposal

This policy brief is based on The Hamilton Project discussion paper, *Getting More from Low-Income Housing Assistance*, which was authored by:

EDGAR O. OLSEN

Professor of Economics, University of Virginia

Olsen's research on low-income housing policy has been published in leading professional journals and edited volumes, he has served as a consultant on housing policy issues to federal and state agencies, and he has testified on these matters before congressional committees.

Additional Hamilton Project Proposals

An Opt-Out Home Mortgage System

Current regulatory responses to the mortgage crisis have important limitations. Disclosure requirements may overload consumers with too much information, while restrictions on specific products may diminish access to credit. This paper uses insights from the growing field of behavioral economics to craft a different approach to improving mortgage markets. The authors employ evidence on consumer bias toward the "default" or status quo to draw families toward financially sound mortgage options. Families would be offered simple mortgages unless they affirmatively opted out, in which case lenders would be required to thoroughly disclose the risks of more complicated alternative products and would face increased liability if borrowers defaulted.

Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises

Conventional mortgages force borrowers to make the same payments regardless of fluctuations in the value of their homes, leaving them to bear all the risk when housing prices fall and thereby exacerbating housing cycles. This paper offers a novel alternative to traditional mortgages: Shared Appreciation Mortgages (SAMs). With SAMs borrowers defer payment until the end of the life of the loan and owe less if their home values fall. In return, lenders share in the appreciation if home values rise. SAMs would thus enhance affordability by reducing monthly payments and reduce the risk of default and future crises by spreading risk more evenly between borrowers and lenders.

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