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RENTAL HOUSING ASSISTANCE?

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Rental Housing Assistance

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Abstract

The worst-case housing needs of low-income households arise largely from their high rent burdens, not from physically inadequate housing. Thus, the programs of housing assistance for these households initiated in the Great Depression should now be recognized as a part of the nation's welfare system, not as an infrastructure investment program. This paper considers the most important implications of these facts for the design of housing assistance programs and for the administration of housing subsidies.

Introduction

Should the public sector provide assistance to very low-income renters? Of course it should. For three quarters of a century, the federal government has provided assistance to low-income renters, beginning with the Public Housing Act of 1937 and extending to the most recent budget proposal of the U.S. Department of Housing and Urban Development (HUD). It is also difficult to imagine that some form of assistance to low-income renters would not be available in the future.

This brief article discusses the rationale for programs that provide renter assistance, the choices about the possible forms assistance may take, and the ways of judging programs' success. Not surprisingly, none of this discussion is about what can be done tomorrow. Instead, it is intended to be relevant to strategic choices by the executive and legislature over some longer time horizon.

Why Subsidize Rental Housing?

Why should the federal government take an active role in policies of subsidizing rental housing? The initial rationale for the provision of public housing during the Great Depression was the acute shortage of decent housing coupled with the recurring unemployment of the time. An unemployment level twice as high as the current rate, along with a lack of effective demand arising from a calamitous recession, launched a program of government-sponsored housing production.

With the post-war boom in the American economy, the comprehensive Housing Act of 1949 emphasized the goal of providing a suitable living environment and decent, safe, and sanitary housing for all Americans. Improved housing conditions formed the rationale for subsidy policies, and progress could be measured by noting the extent to which inadequate housing was eradicated. In 1975, about 2.8 million renter households lived in severely inadequate housing, representing almost 11 percent of renter households. By 2001, the number of inadequately housed households (by Housing Act of 1949 standards) declined by 60 percent (Quigley and Raphael, 2004). This number has subsequently declined by another 15 percent. The fraction of renters living in severely inadequate housing was less than 3.5 percent of the population in 2004, and it is now below 3 percent. Among dwellings that are affordable to the poorest households (those earning less than 30 percent of the median income of the local area), the fraction of severely inadequate housing was about 5.3 percent in 1999, according to the Bipartisan Millennial Housing Commission (2002). Among dwellings affordable to low-income households (those earning between 50 and 80 percent of local median income), the fraction classified as severely inadequate was 2.9 percent. More than a decade later, physically inadequate housing is certainly a concern for some households, especially the poorest renters. But even for the very poorest households, less than 5 percent of those who pay less than 30 percent of their incomes on rent live in severely inadequate housing conditions.

Thus the maintenance of housing quality (decent, safe, and sanitary housing) does not provide a very convincing rationale for extensive public subsidies for rental housing in the 21st century. Indeed, this seems to be recognized now (at least implicitly) by politicians, scholars, advocates, and interest groups. For example, the worst case housing needs, reported by HUD to Congress (HUD, 2000), emphasize high rent burdens as the source of worst case housing needs. In 2000, the Senate directed HUD to compile and report the extent of worst case housing needs annually. Because the extent of substandard housing is so small, these reports are essentially estimates of the fraction of households in various demographic groups paying more than one-half of their incomes for rent and estimates of the fraction of households living in overcrowded conditions. Worst case housing needs have evolved into another way of describing poverty.

Affordability is clearly the most compelling rationale for polices subsidizing rental housing. The high cost of rental housing, relative to a low-income household's ability to pay for housing, leaves these households with few leftover resources for expenditures on other goods—such as food, clothing, and medicine—which are also necessities. Because housing represents a large share of household expenditures in market-based economies—for the middle class and the poor—small changes in the rent burdens that households face can have large effects on their levels of well-being. Improved well-being, along a variety of dimensions, will almost certainly arise if housing programs provide increased discretionary resources to recipients by reducing their rent burdens. In addition, rent burdens are reduced if recipients of housing assistance choose to spend proportionately less of their transfers on housing relative to other necessities. The affordability of housing is certainly a legitimate rationale for housing subsidy policies. Indeed, as noted previously, it seems to be the only surviving rationale for a large-scale subsidy program for rental housing in the United States.

This perception suggests that rental housing programs for low-income households ought to be thought of as a part of the U.S. welfare system—in the same way that we think of income transfers, food stamps, and the Earned Income Tax Credit (EITC) as components of that system. Receipt of food stamps has a miniscule effect on the food consumption of poor households (the transfers are inframarginal), but the program frees up household resources for consumption of other necessities.

Transfers for housing assistance have positive effects on housing consumption (they are not quite inframarginal), but their principal success is a reduction in the high rent burdens that recipient households face.

Some consider this welfare system to be inferior to a system that instead transferred unrestricted cash to poor households. But it is hardly unreasonable to suppose that donors' preferences place more weight on the food and shelter available to the poor than upon the other consumption items available to them. Others may note that since transfers are largely inframarginal, they do not distort recipients' choices very much.

This perspective highlights the most conspicuous failure of the current system of historically evolving housing subsidy programs—the horizontal inequity accorded to similarly situated, otherwise identical, households. Under current programs, qualifying households obtain rental housing subsidies through some random process. Households apply for housing assistance through local housing authorities. Despite widespread presumptions to the contrary, virtually all local authorities have long waiting lists. Indeed, in many housing authorities, waiting lists themselves are often closed. This means that qualifying households can wait years before obtaining rental assistance. Independent housing authorities have their own systems for ranking eligible households. Most authorities adopt some sensible procedure for granting priorities, but selection onto the waiting list and selection from the waiting list has many of the characteristics of winning the sweepstakes.

Compare this procedure with the process of obtaining food stamps or medical assistance under Medicaid. Households are deemed eligible on the basis of income, household size, and other demographics (such as disability), and all eligible households qualify for assistance. The only form of welfare assistance that is awarded under the sweepstakes model, rather than the eligibility model, is rental housing. And, as noted previously, housing expenses consume a large fraction of low-income households' incomes. So the inequity of the sweepstakes model is even more glaring. A fraction of eligible households receive a large subsidy. A larger fraction of eligible households receive no assistance. The distribution is capricious.

For example, Currie (2006) reported that under current rental subsidy policies, more than 70 percent of households below the poverty line are not served, and more than 40 percent of the households who are served are not in poverty. A couple of years ago, it was reported (Quigley, 2008) that less than one-third of renters with incomes below 30 percent of the local median received housing assistance, and less than one-fifth of renters earning between 31 and 50 percent of local median received housing assistance.

Could Anything Really Be Done?

Maybe nothing can be done to correct this imbalance, but something closer to equitable assistance for poor renters could be achieved if the eligibility rules for housing subsidy were made more realistic and if the program were financed using the successful models employed in other U.S. housing subsidy programs.

First, eligibility rules for rental housing assistance would need to be tightened. Under current law, households with incomes below 80 percent of the Area Median Income (AMI), adjusted for household composition, are eligible for rental housing subsidies. In 2006, this average cutoff income was about $52,000 for a family of four (Quigley, 2008). At that time, eligibility for food stamps for four-person households was confined to those with incomes less than one-half as large ($25,000). Eligibility under the EITC program was limited to households (with one or more children) earning one-third less per year ($37,000). Eligibility for rental assistance would have to be tightened considerably to replace a national lottery program with a broader and more equitable program for housing assistance for very low-income renters.

Objections exist to the labor supply implications of adding another income-based entitlement program to the array of federal policies. Much of this concern seems misguided, or else simply rationalizes opposition to a more transparent and universal housing assistance program.[1]

Second, a broader program would require additional support outside the community of housing advocates and professionals, and the continuity of the program would be problematic. One way to increase political support, and to reduce administrative costs as well, would be to follow the politically successful programs of subsidies to homeowners and subsidies to builders for the construction of low-income housing. (New construction of low-income housing is discussed further in this article.) These programs use the relatively efficient systems of the Internal Revenue Service (IRS) to determine eligibility and to distribute the benefits.

Currently in the United States, the multibillion-dollar home ownership subsidies are distributed largely by the IRS. Individual taxpayers need not report the dividend (that is, the imputed rent) on owner-occupied housing. Interest and property tax payments are deductible as personal expenses, and capital gains on sale are accorded special treatment in the computation of tax liability. (Jaffee and Quigley [2007 and 2010] provide estimates of the costs of these provisions. The costs are large.) The distribution of these subsidies to qualifying households is relatively painless. The subsidy is paid as a credit against the other tax liability of a homeowner. But subsidies provided under these provisions of the tax law for owner occupants are not refundable to the taxpayer.

In contrast, EITC is fully refundable to the taxpayer. Eligibility for the credit can be established on line (using the "EITC assistant," for example). Alternatively, the IRS will establish eligibility and will compute the credit due—and they will also send along a check—to any qualifying taxpayer. A refundable credit is not hard to administer.

In fact, a housing program that the IRS already administers could serve as the template for a low-income rental housing subsidy program of this kind. The Mortgage Credit Certificate Program authorized by the Deficit Reduction Act of 1984 entitles selected homeowners to claim a tax credit for some portion of the mortgage interest paid in any year, rather than the tax deduction afforded other homeowners. (See Greulich and Quigley [2009] for a detailed discussion.) A taxpayer in

[1] Evidence indicates weak effects of the EITC on the labor supply of recipients (Eissa and Hoynes, 2006), and stronger effects of welfare receipt upon labor market outcomes. (See Moffitt [2002] for a review.) Less is known about the work incentives of the food stamp program (Hoynes and Schanzenbach, 2010). Fischer (2000) found small effects of housing assistance on work incentives, and Shroder (2002) found essentially no effects of housing assistance upon the employment of recipient households. Clearly, it is to be expected that any labor market distortions under a universal housing assistance program would be smaller than these estimates, not larger (because an entitlement program would undoubtedly provide a lower level of benefit, but one enjoyed by many more households).

possession of a Mortgage Credit Certificate issued by a unit of state or local government merely checks a box on his or her tax return (on line 54 of Form 1040) and submits an additional form (Form 8396, only 11 lines long) to claim the nonrefundable credit.

To claim the low-income housing subsidy under this more equitable low-income renter assistance program, the taxpayer would need to submit a form issued by a local housing authority and check a box added to the current IRS form. The additional form would certify that the household was renting a dwelling that meets the minimum habitation standards imposed by HUD. That form, together with the income reported by the household, the number of dependents in the household, and the postal address of the household, would be sufficient to compute the low-income renter subsidy payable to any household.[2] The computation could be made by any taxpayer (perhaps on line) or by the IRS, as is the case with the EITC. Of course, H&R Block or any other commercial tax preparer could also make the computations. The private sector would have an incentive to help administer the program.[3]

The appropriate credit could be mailed in monthly installments to the low-income household, to the local housing authority for distribution to the household, or to the landlord directly.

Financing the low-income renter assistance program through the IRS and administering the program through HUD may also facilitate long-overdue reforms to the tax code in the treatment of housing. For example, a revenue-neutral way to finance a low-income renter assistance program of roughly the same size as all current HUD low-income subsidies would be to eliminate the capital gains exclusion currently afforded to owner occupants when they sell their dwellings (Jaffee and Quigley [2007 and 2010]). Reducing the limits on the deductibility of interest payments for high-income homeowners could easily finance a more equitable universal program. Using the tax code to support low-income renters may thus further national goals of equity in the tax treatment of housing by the federal government.

What About Unit-Based Housing Subsidies?

Viewing rental housing subsidies as part of the modern welfare system is very different from conceptualizing these subsidies as part of an infrastructure investment program—the rationale for the program 70 years ago. Ensuring equal treatment of eligible households as a part of a national welfare program is quite different from a policy of using rental subsidy funds to design and build new dwellings to be rented at below-market rents—at any conceivable budget. And the reason is obvious.

The cost of providing decent-quality housing through new construction is much greater than the cost of providing it by using the existing depreciated stock of housing. This fact is well known to

[2] It would be simple to differentiate the payment by postal code (and hence metropolitan area) if it was considered desirable to vary subsidies by the local cost of living. Most economists would probably not support such differentiation (for example, Glaeser, 1998), but many politicians might.

[3] The computations would be a bit more complicated than those under the EITC because incomes of potential recipients may vary within the year. Currently, no administrative mechanism exists in the IRS for recertifying incomes within the year (perhaps on a quarterly basis). But this duty could be assigned to local housing authorities, whose other burdens would be reduced under the proposed housing subsidy program.

builders and developers, who almost never target new construction of rental units to the bottom one-half of the income distribution. (This fact is also quite well known to slumlords, who offer small quantities of housing services to the poor, using the oldest and most obsolete portion of the housing stock.) These cost differences in shelter provision for low-income households were thoroughly documented in conjunction with the Experimental Housing Allowance Program a quarter of a century ago and, more recently, by the General Accounting Office (GAO, 2001, 2002), now the Government Accountability Office. The latter study concluded that the present-value life-cycle costs of new construction subsidies were from 19 to 38 percent more than were the costs of voucher programs for comparable housing.[4] No conceivable budget that sought to cover all renters below some income cutoff level could make provisions for the expenditures that are required to provide newly constructed housing for assisted households.

Should programs that provide unit-based housing assistance (that is, housing subsidies tied to particular dwelling units) be discouraged? Currently, a little more than two-thirds of the low-income renter households subsidized through the Section 8 program (2.2 million recipients) receive vouchers that can be used locally and which often are portable regionally. These vouchers make up the difference between 30 percent of household income and the estimated costs of "just standard" housing. In contrast, about one-third of Section 8 recipients receive equivalent financial subsidies in designated dwelling units under long-term contract to HUD. The benefits provided to recipients under the latter arrangements (unit-based assistance) are not as valuable as those provided by unconstrained vouchers. The recipient of a voucher could always choose the designated dwelling unit if it most closely matched his tastes and preferences, but the recipient of an unconstrained voucher could also choose another unit. A voucher recipient can also change dwellings in response to job changes, schooling needs, or neighborhood conditions.

Beyond these advantages to the individual recipient, the system of unconstrained vouchers provides an additional incentive for the deconcentration of low-income households in urban areas. Those who are willing to incur search costs (and perhaps other nonmonetary costs associated with integrating neighborhoods by income and race) make it easier for those searching subsequently in the housing market. None of these spatial incentives are present in unit-based Section 8 housing. Indeed, some concern exists that unit-based assistance concentrates disadvantaged renters.[5]

The imposition of geographically determined unit-based housing assistance under Section 8, instead of portable and flexible vouchers available under the same program, might be understandable—

[4] This additional cost is apparently well known, if not extensively documented. For example, the analysis of the Moving to Opportunity (MTO) experiments by Kling et al. (2007) concluded that the MTO treatments pass the cost-benefit criterion because "the MTO intervention[s] produced large mental health improvements and because other research suggests that it is cheaper to provide a unit of subsidized housing with vouchers than in a public housing project" (2007: 108).

[5] Little evidence supports the theory that supply-side housing assistance helps to disperse low-income households across neighborhoods. For example, Freeman (2004) reported that newly subsidized units created under the tax credit program are located in neighborhoods that contain a disproportionate share of Black residents. These neighborhoods also have considerably higher poverty rates, lower median incomes, and lower house values than typical metropolitan neighborhoods. It should also be noted, however, that little evidence indicates that voucher recipients use vouchers to purchase housing in better neighborhoods. Under the MTO experiment, for example, recipients of MTO vouchers were required to move to neighborhoods with much lower concentrations of low-income households. After about a year, however, a large fraction of MTO recipients moved again—to neighborhoods with higher concentrations of poor households. (See Quigley and Raphael [2008] for a discussion.)

if the former was cheap enough relative to unrestricted vouchers. But no evidence suggests that this is the case.[6] Absent a compelling rationale based on comparative costs, it would be administratively simple to unwind unit-based housing assistance over time, as contracts with landlords expire, and replace them with more flexible vouchers.

Of course, there may be circumstances in which just standard, but depreciated, units are, in fact, cheap enough to make federal leases of these units competitive with demand-side assistance—especially if these leases also reduce negative external effects. Under current market conditions, in regions with high vacancy rates and abandoned properties, federal assistance to private or non-profit owners in return for shelter provided to low-income renters may well pass a strict welfare test. If acquisitions can be made cheaply enough, if external effects (for example, from abandoned or foreclosed properties) are large enough, a place-based subsidy program might be quite sensible, at least in the short term.

What About Newly Constructed Low-Income Housing?

The Tax Reform Act of 1984 eliminated a number of housing construction programs and, at the same time, introduced the Low-Income Housing Tax Credit (LIHTC) Program. Under the LIHTC Program, a per capita tax credit is allocated to each state to support new construction projects by private developers. The per capita tax credit was increased several times before being indexed to national changes in per capita income. Developers who have been allocated tax credits by the states sell them to private investors and invest the proceeds in building low-income housing projects. In common with the subsidy program for owner-occupied housing, the IRS administers the LIHTC Program—and, of course, neither program is subject to annual congressional appropriations.

To qualify for tax credits under the LIHTC Program, projects must ensure that 20 percent of the new units are occupied by renters earning less than one-half of the AMI or that 40 percent of the new units are occupied by renters earning less than 60 percent of the AMI. Rents in these set-aside units are capped at 30 percent of the HUD-determined income for the area (not 30 percent of the incomes of individual renters). Tax credits may be increased if the chosen neighborhood has a high poverty rate. In practice, LIHTC subsidies are often combined with tax-exempt bond finance, Community Development Block Grant funds, and other public sector subsidies. This arrangement makes it very difficult to understand the cost of the subsidy provided to the qualifying tenants in any LIHTC project. (Note, for example, the complexity encountered by Cummings and DiPasquale [1999] in their comparison of LIHTC projects over time and place.)

In the quarter of a century that the LIHTC Program has been in place, about 1.6 million units of subsidized housing have been produced. The program is successful with politicians and builders (and profitable for them as well, if the excess demand for LIHTC projects among builders is any indication). But the GAO report, noted previously, estimates the cost of subsidizing renters by building new LIHTC dwellings is about 16 percent more expensive than using vouchers.

[6] The GAO studies noted previously are not really relevant because they compare the subsidy costs for newly constructed or rehabilitated units with those for households subsidized by Section 8 vouchers.

As noted previously, building new dwellings to subsidize low-income households is inevitably more expensive than providing equivalent housing using the existing depreciated housing stock. Thus, if this program and other public programs that construct new or rehabilitated housing for low-income households are to be justified on economic grounds, they must be justified on some other basis. The private benefits to low-income recipients are not worth the considerable cost of these programs.

Depending on the design of these projects, their scale, and their particular locations, however, specific projects may indeed provide substantial economic development benefits for the neighborhoods and cities in which they are located. Under the well-known criteria of welfare analysis, these external benefits can be approximated by the aggregate effect of any project on the property values in the surrounding area. Given the high cost of the housing subsidy in new construction projects relative to those using the existing depreciated capital stock, an external effect on local property values is a necessary condition for undertaking a project, at least using the criterion of economic efficiency.

It is surprising how little attention has been paid to the importance of these externalities ex ante, and even more surprising is how little systematic research has been undertaken on these issues, ex post. Under the LIHTC Program administered independently by the 50 state governments, no requirement exists that the external effects of proposed projects be taken into account at all. Apparently no explicit mechanism exists for evaluating external effects of the distribution of funds for the rehabilitation of public housing.

In legislation enacted in 2005, however, a statutory preference was accorded to LIHTC projects located in census tracts, "the development of which contributes to a concerted community revitalization plan." (26 USC 2005 ¶ 42) As reported by Orfield (2005: 1779), this

> "preference was never discussed in recorded debates in Congress. No mention of it appears in any legislative debate, any committee report, or in any newspaper report at the time."

Perhaps the enforcement of this provision could be monitored somewhat more closely ex ante by HUD officials and evaluated ex post by the agency.

Analyses of the importance of any external benefits of housing investments have not been prominent in the program evaluation literature, and only a small number of credible studies document the magnitude of external effects for any housing programs. Briggs et al. (1999) investigated the effects of scattered-site public housing on nearby property values in Yonkers; Santiago et al. (2001) used a substantially similar research design to analyze the effects of public housing on property values in Denver. Lee et al. (1999) investigated the effects of several housing assistance programs on nearby property values in Philadelphia, and Ellen et al. (2007) conducted a similar analysis using data from New York City.

Several research papers have analyzed the effects of New York City housing investment policies on neighboring property values (Ellen et al., 2002; Schill et al., 2002; Schwartz et al., 2006).

Apparently, only two studies, by Green et al. (2003) using repeat sales data on housing from Milwaukee, and by Ellen et al. (2009) analyzing micro data from New York, examine the effects of LIHTC projects on nearby property values. The Milwaukee study has never been published.

This work hardly represents an outpouring of research activity, and one cannot help concluding that the incentives for addressing these issues ought to be a lot stronger, especially before expensive subsidized investment decisions are made.

For the housing investment programs under HUD's immediate control—public housing programs like HOME and HOPE VI—investment decisions ought to consider carefully and weigh heavily the economic development consequences of alternative choices, not merely the housing implications.[7]

For housing investment programs that the IRS controls—principally the LIHTC Program—the role of other government agencies, such as HUD, is less clear. HUD could provide financial incentives to state tax credit allocation commissions to consider prominently the economic development consequences of their tax credit investment projects. Or HUD could provide technical assistance so that state decisionmakers would be better informed about the potential external effects of specific projects. HUD could also work more closely with the IRS to devise rules that would reward states for considering the broader development implications of their tax credit allocation decisions.

These activities to encourage the more prominent consideration of economic development in housing investment decisions would be consistent with the recommendations and exhortations of the National Research Council's (2008) analysis of the research capacity of HUD.

What Else?

Of course, not all housing problems of low-income households can be addressed by transferring resources to poor households, even if those transfers are carefully earmarked to improve housing outcomes. In addition, economic development projects that include new low-income housing are not sufficient either. Low-income households with disabled, elderly, and special needs people may not be well-served by participation in expanded voucher programs. Some fraction of the homeless population is not simply poor. These individuals and households are also disabled. They require housing in a supportive environment that can best be provided collectively by government, or at least supported by public resources and monitored by the public sector. These considerations flow from recognizing that housing subsidies are better considered as part of a welfare system, and not as an infrastructure investment program.

Finally, the vigorous enforcement of equal opportunity in housing is a precondition to the functioning of an expanded market-based voucher system for low-income renters, and continued vigilance in the eradication of those regulations that restrict locations for the construction of rental housing is also necessary.

[7] The Choice Neighborhoods Initiative announced by HUD in July 2009 may be intended to encompass economic development more generally, but at this point it is difficult for outsiders to know. The effect of HUD's housing investments on neighborhood economic development should be a very important factor in allocating scarce resources.

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