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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT—INDEPENDENT AGENCIES APPROPRIATIONS FOR 1978

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HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

FIRST SESSION

SUBCOMMITTEE ON HUD—INDEPENDENT AGENCIES

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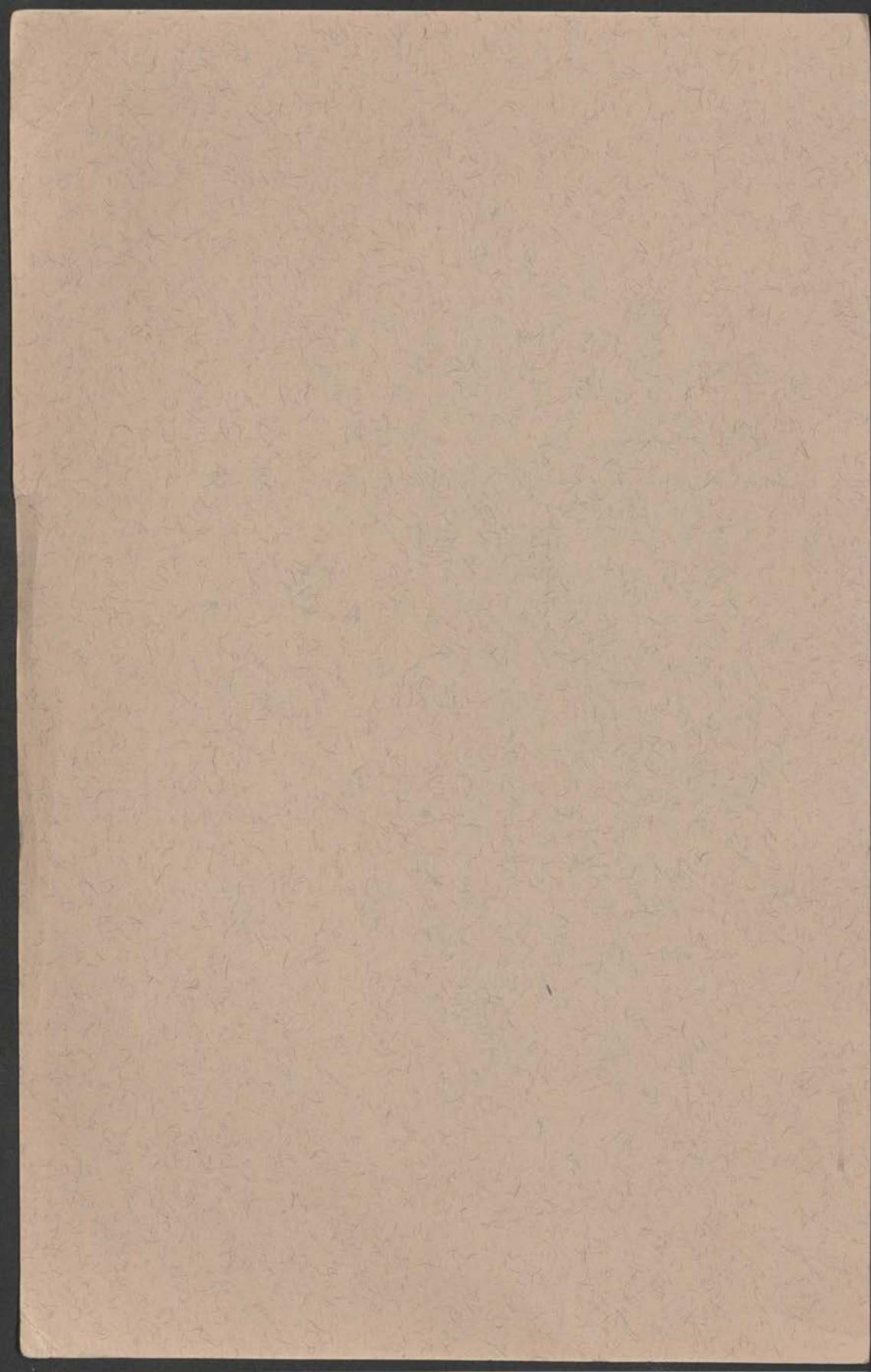
PART 8

SUBSIDIZED HOUSING

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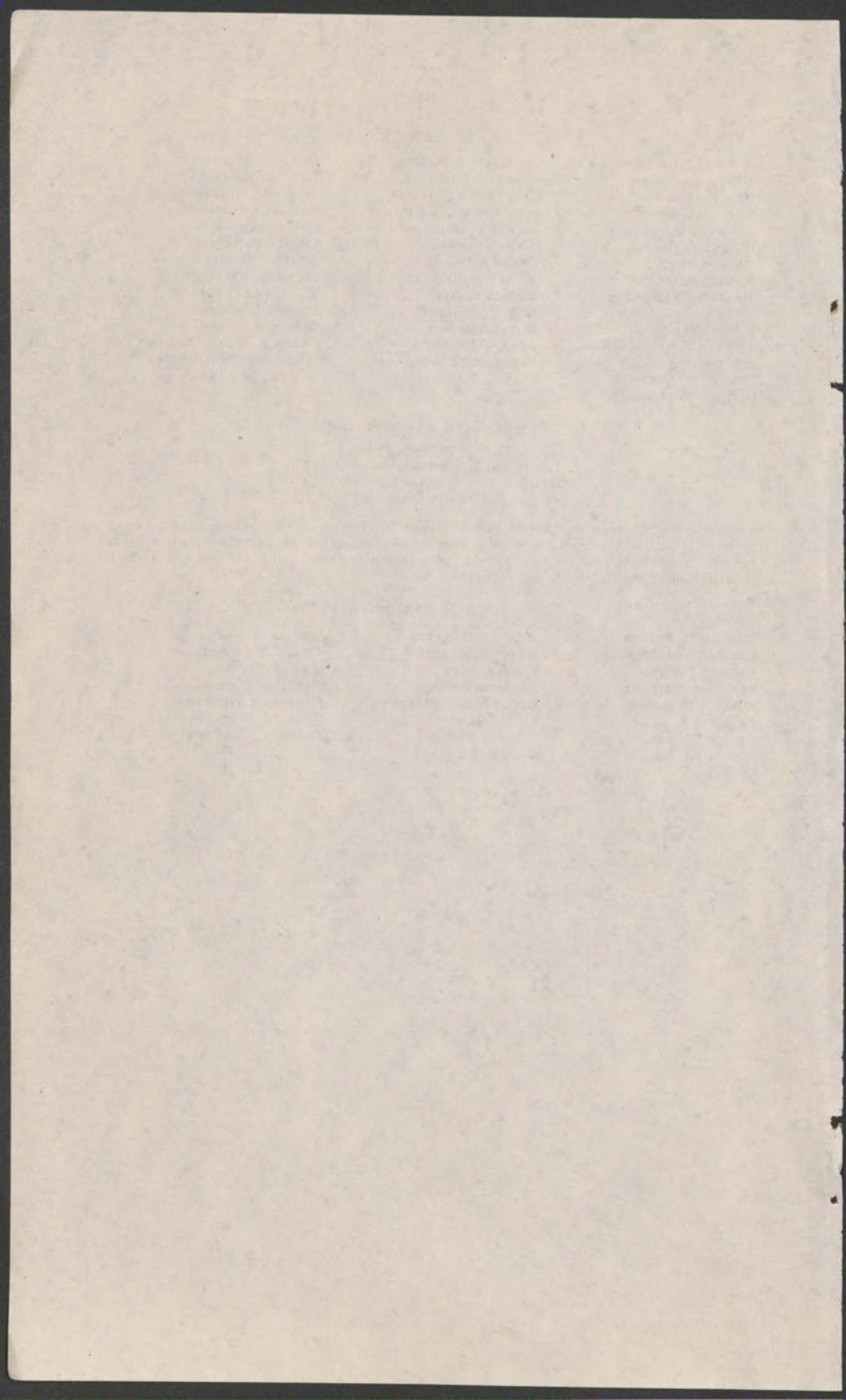
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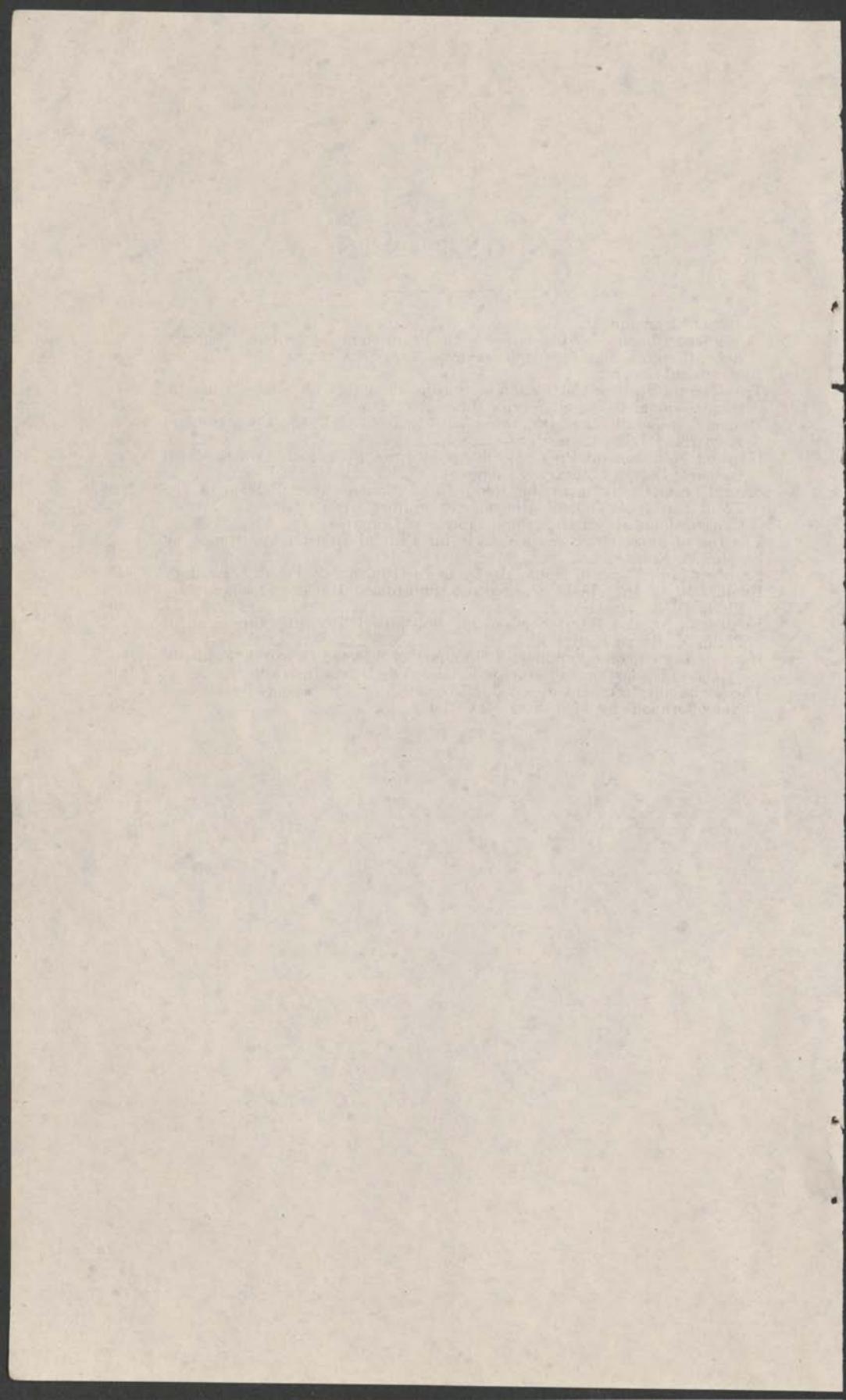
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*SUBSIDIZED HOUSING—WHERE DO WE GO
FROM HERE?*

A Study Prepared by

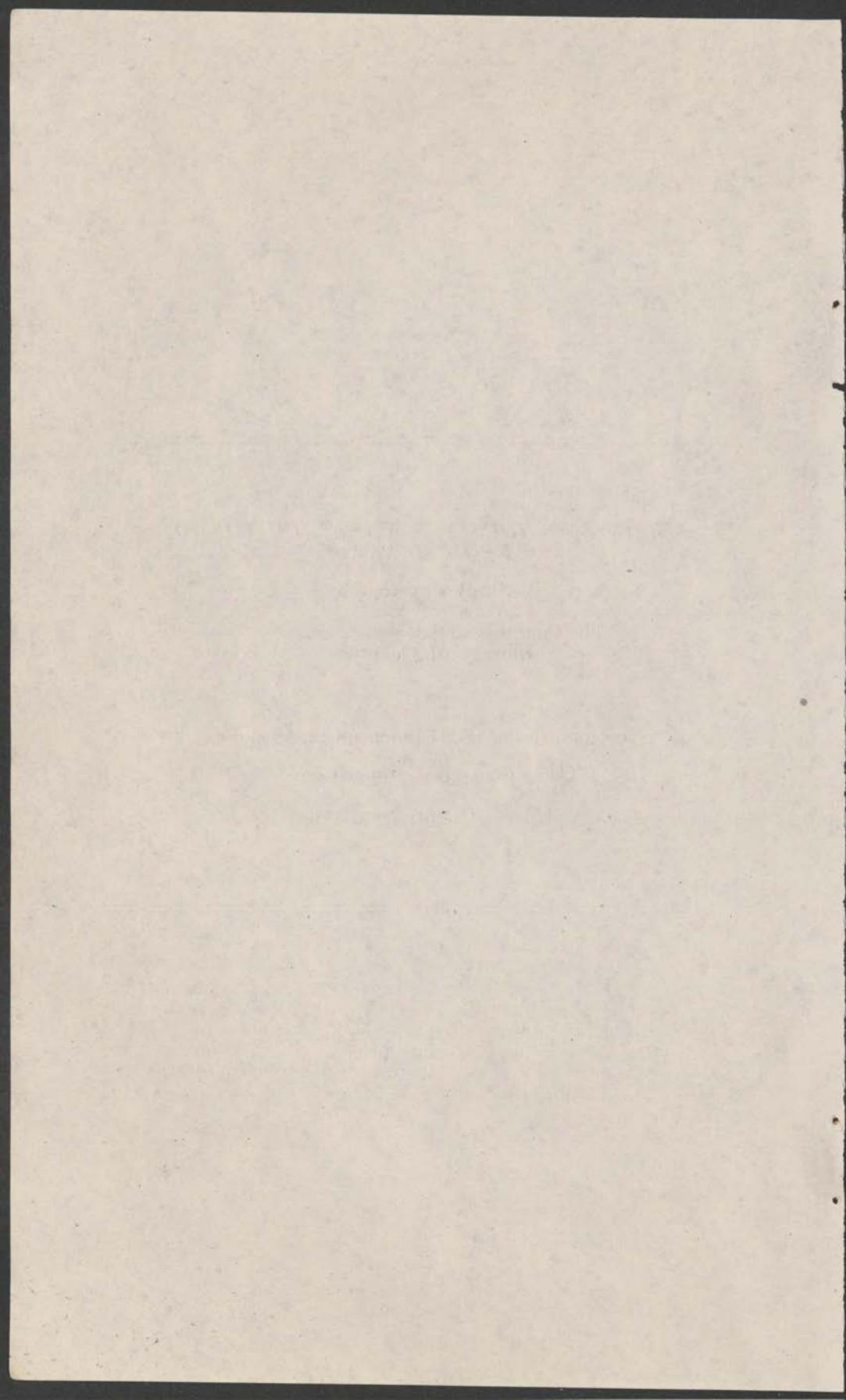
The Congressional Research Service,
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for

Subcommittee on HUD-Independent Agencies

Committee on Appropriations

House of Representatives



AUGUST 18, 1976.

Dr. NORMAN BECKMAN,
Acting Director, Congressional Research Service, Library of Congress, Washington, D.C.

DEAR DR. BECKMAN: The Subcommittee on HUD-Independent Agencies has struggled for the past 3 fiscal years with the problems associated with funding a workable and cost-conscious housing subsidy program for low- and moderate-income American families. The section 8 approach is the current principal program available for implementing housing subsidies. It replaced the section 235, section 236, rent supplement, and conventional public housing programs. When the section 8 program was first proposed, the committee raised a number of questions concerning its ultimate cost and workability. At the time, in April 1974, HUD strongly disputed any suggestion that section 8 would be more expensive than section 236 or public housing. Recently, both the GAO and Dr. Schussheim, the senior specialist for housing in CRS, have independently concluded that section 8 new construction is more expensive than conventional public housing. This, of course, confirms the committee's original concerns.

In view of this, and in view of the fact that the Banking Committees and the Appropriations Committees in both the House and Senate have now reopened the conventional public housing program for new construction, we are requesting that Dr. Schussheim direct a major study examining the general premise of "where do we go from here" with subsidized housing. The committee is particularly interested in what kind of a housing program, or what kind of a mix of different housing programs it should ultimately fund in fiscal years 1978 and 1979. Such questions as should the local community provide some subsidy in the form of foregone taxes—how much and how deep should the subsidy be; how broad should the coverage be; what role does rehabilitation play and what role should it play; how many units conservatively should be financed in each fiscal year; can any new construction program be successful that is not totally subsidized—are important to the subsidized housing issue.

In short, the committee requires a general philosophical analysis of the current subsidized housing problems and some specific recommendations, based on what has been learned over the past 20 years, concerning what kind of program direction should be funded in the coming years. Because subsidized housing programs are expensive—and because they commit the Federal Government to long term contractual obligations, the committee believes it is important to have independent expert advice in this area.

The Library should use whatever resources, in addition to Dr. Schussheim, are required to complete this study. This includes tapping the General Accounting Office, the Congressional Budget Office, and

contracting for whatever additional help may be necessary. The committee would appreciate having this "white paper" on subsidized housing by March 1, 1977. Any questions should be raised with the subcommittee staff.

Thank you for your help and cooperation in this matter.

Sincerely,

GEORGE MAHON, *Chairman,*
Committee on Appropriations.

EDWARD P. BOLAND, *Chairman,*
Subcommittee on HUD-Independent Agencies,
Committee on Appropriations.

THE LIBRARY OF CONGRESS,
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Washington, D.C., March 15, 1977.

HON. GEORGE MAHON,
Chairman, Committee on Appropriations.

HON. EDWARD P. BOLAND,
Chairman, Subcommittee on HUD-Independent Agencies, Committee
on Appropriations

GENTLEMEN: I am pleased to transmit herewith a report prepared by the Congressional Research Service at your request on the subject of subsidized housing. The report is called "Subsidized Housing—Where Do We Go from Here?"

Your request was for a "white paper" that would address some crucial issues in determining an appropriate housing policy for the Nation. We believe this report is responsive to your requirements and at the same time consistent with our charter to prepare objective and nonpartisan analyses.

This study was a joint effort involving a number of CRS personnel as well as outside consultants. CRS staff members who wrote papers or performed other related work were: Michael A. Agelasto, II, Barbara O. Maffei, Barbara Miles, Grace Milgram, Francis Parente, and Anne M. Smith.

The following consultants also provided advice: Philip N. Brownstein, assisted by Morton W. Schomer, Barry P. Rosenthal and Eleanor Roberts Lewis; John M. Frantz; Frank S. Kristof; M. Carter McFarland; and David B. Carlson, Morton L. Isler, and John Heineberg of the Urban Institute. All papers and monographs written in connection with this study are being made available to the Committee.

The project was carried out under the general direction of Morton J. Schussheim, who also wrote the final report.

It is our hope that this study will contribute to the shaping of effective national programs and policies on housing by your committee and the Congress.

With warmest regards.

Sincerely,

GILBERT GUDE, *Director.*

SUBSIDIZED HOUSING—WHERE DO WE GO FROM HERE?

(Prepared at the request of the Committee on Appropriations, U.S. House of Representatives by Morton J. Schussheim, Senior Specialist in Housing)

For more than 40 years the Congress has been concerned with encouraging investment in housing and raising housing standards of American families. This interest has extended to all income levels and resulted in laws ranging from insuring deposits of thrift institutions to tax preferences for homeowners to payments on bonds issued by local housing agencies. These Federal supports have helped make it possible for most Americans to translate rising incomes into marked improvements in housing standards. Today two out of three families are homeowners. For many of these families their homes represent the principal means of accumulating equity as they pay down mortgage debt and to the extent that home prices rise.

Why has the Federal government become so involved with housing? For one thing, residential mortgages make up a substantial portion of the assets of commercial banks and other financial institutions. In the 1930's when borrowers in large numbers were unable to meet their monthly payments or refinance their unamortized mortgage loans, many lenders found themselves with illiquid holdings of mortgages and real estate. The Government was not prepared to permit these financial institutions to go under. At the same time there was concern about homeowners who were threatened with loss of their homes or forced sales at distress prices. These Depression events induced the Congress to authorize the Federal Home Loan Bank System the Federal Housing Administration, deposit insurance and other measures that have made mortgage lending a mixed public-private enterprise.

High unemployment among construction workers and others was another reason for governmental intervention. In the 1930's Federal funds were made available for many types of public construction including community facilities and public housing. Recurrent cyclical fluctuations in private homebuilding in more recent decades have demonstrated the close relationship between housing activity and monetary actions taken to stabilize the general economy. Housing has been a football between the monetary authorities who have found in this sector a useful way to turn down an overheated economy and congressional supporters of housing who have periodically authorized additional Federal credit to stimulate housing construction.

Cultural attitudes and social concerns have also played some part in shaping national policy toward housing. The earliest English settlers in America brought with them a strong belief in private ownership of property. To this day there is an implicit conviction that homeownership is important to a stable and responsible citizenry. Tax breaks for homeowners reflect contemporary Federal support for this form of investment.

The Nation has been less consistent, however, in its commitment to help the poor. In colonial times local jurisdictions tried to avoid the burden of the poor and to pass the problems on to other places. Historically, big cities like New York, Boston, and Philadelphia have absorbed a disproportionate share of the poor. In the early decades of the 19th century there was little sympathy for paupers and unemployed workers, many of whom were foreign-born. Community attitudes toward the poor softened somewhat in the latter part of the 19th century: rising social income, new knowledge about the handicapped and other disadvantaged groups, and the spread of humanitarian sentiment brought improvements in the treatment of dependent members of society.

In the present century Federal legislation has provided help to the elderly, the disabled, and families with dependent children. But what has evolved, in the view of some observers, is a two-track system of social supports, one for the working population and another for the welfare population. In health care for the elderly, for example, Medicare is available to social security recipients who pay a portion of the costs; Medicaid for the indigents. In public housing a similar separation of working families and welfare families was set in motion in 1949 with the decision to evict overincome tenants from federally-aided projects.¹ (An alternative would have been to raise the rents of such families in line with their rising incomes up to a full economic rent.) As a consequence, public housing increasingly has become, in the 1956 words of Elizabeth Wood, a former director of the Chicago Housing Authority, "the permanent home for the damaged, the non-normal, the dejectedful [rather than] the temporary home of the capable, the ambitious."² By 1975 the decline of otherwise self-sufficient families among nonelderly occupants was pronounced: 54 percent of the nonelderly families reexamined for continued occupancy were on assistance or receiving other forms of benefits.³

In short, a two-track system appears to prevail in federally-assisted housing, as in other federally-involved social sector programs. Not only is public housing increasingly accommodating welfare families; early observations of the more recently authorized lower income housing assistance program—section 8—suggest that a substantial proportion of enrolled families are also receiving other forms of public assistance. The trend is clear: whether by design or default, Federal housing programs seem to segregate the poor and keep them apart from the upward mobile families in the community.

Economic and social considerations

The Federal Government is now deeply involved in housing, but its commitment is bounded by the realities of economic forces and social trends. These include:

1. *Persistent inflation.*—Since 1966 the American economy has experienced a steady rise in prices at an average rate of almost 6 percent

¹ See Abner D. Silverman, "User Needs and Social Services," papers submitted to Subcommittee on Housing Panels, House Committee on Banking and Currency, June 1971, pp. 579-606.

² *Ibid.*, p. 601.

³ Other than social security payments (OASDI) only. Among the elderly families reexamined for continued occupancy, 51 percent were receiving some forms of assistance or benefits other than social security payments only; the latter group comprised 39 percent of the elderly.

a year compounded. In 10 years the cost of living has climbed by 75 percent.

The expectation of persistent inflation discourages lenders from making long-term loans at fixed returns since they will be repaid in dollars of declining value. So lenders look for shorter-term loans. Among the borrowing sectors that are most adversely affected by inflationary expectations and high interest rates are home purchasers and local governments. So long as general inflation rates are in the range of 5 to 7 percent, residential mortgage yields will probably stay between 8 to 10 percent.

2. *Low productivity.*—Productivity is difficult to measure, but there is general agreement that long-term productivity gains have been relatively high in farming and durable goods manufacturing and relatively low in construction and service sectors such as local government. This is reflected in cost indexes: home construction costs in 1976 up more than 100 percent above 1967 levels, sewer construction costs an estimated 125 percent higher, and State and local government service costs up 91 percent. Low productivity in construction and local government is a burden for families when they first buy a house and when they pay property taxes that tend to increase year after year.

3. *Rising energy costs.*—Prices of fuel have risen faster than overall consumer and wholesale prices since 1974 and will probably continue to do so in the next several years. For homeowners, expenditures for fuel and utilities have been going up an average of almost 10 percent a year since 1970. Thus it is not only development costs of housing that have worked against families seeking homes but operating expenses as well. Rising costs of heat and utilities have also been a major factor in the financial distress of many public housing and other subsidized housing developments in the past 5 years.

4. *Environmental protection.*—Only in recent times has the Nation begun to pay serious attention to the damage to the environment resulting from industrial activity, motor transportation, and related causes. Efforts to improve the environment were endorsed by the Congress in 1969 but quickly collided with other national objectives including the increase in housing production called for in the housing legislation of 1968. Environmental regulations attempt to correct for spillover costs that are passed on by one jurisdiction or industry to others. Investments by electric generating companies to reduce air and water pollution to levels mandated by regulatory agencies are estimated to add about 10 percent to total capital outlays of such companies.⁴ Similarly, housebuilding costs have been increased by indeterminate amounts as a result of environmental regulations. The added costs reflect not only improvements in water and sewer facilities but also long waiting periods for the preparation and approval of environmental impact statements and higher land prices in some places attributable to limitations on buildable sites.

5. *Population shifts.*—The largest metropolitan areas are no longer as attractive to people as they were a decade or two ago and they are growing at slower rates than earlier. Meanwhile, the smallest metropolitan areas and formerly nonmetro counties have grown faster than before. Regionally the movements are from the Northeast and North

⁴ Economic Report of the President, January 1977, p. 153.

Central parts of the country to the South and West. These shifts will result in underutilized housing and public facilities in some areas and shortages in others. Those left behind in the slow-growing or declining areas are likely to include a disproportionate number of poor people including the elderly poor. This has been happening within metropolitan areas and will probably occur in the regional movements as well.

6. *Age distribution and housing demand.*—For at least the next 10 years the demand for single-family housing is expected to be strong. The record numbers of persons born in the baby boom of 1947–56 will be in the age band of 25–35 in the years immediately ahead. If they emulate their predecessors, most will be candidates for single-family homes. But homeownership may prove more elusive or burdensome than in the past if house price increases continue to outpace income gains.

7. *Living alone.*—More and more people seek separate accommodations. Not only are relatively more elderly persons choosing to live in their own places but younger, unmarried adults as well. Since 1970 slightly more than half of the added households have been primary individuals. This preference for independent living adds to housing requirements and may also result in some underutilization of space, particularly among the elderly.

8. *One-third of a nation.*—The people with the least adequate housing and the heaviest housing burdens will continue to be the lower income third of all households. A barely adequate budget for an urban family of four was about \$10,100 in 1976.⁵ About a third of all American families had incomes lower than this last year. Approximately the same proportion of households headed by a person 65 years and over had incomes below \$4,000 a year.⁶

Among the lower income third of the Nation are the most deprived of all—the 5½ million families and 5 million unrelated individuals subsisting below the poverty level.

Through the remainder of this decade at least, the housing expenses of lower income families can be expected to rise much faster than incomes and further raise proportions of income that must be spent on housing. Competition for housing subsidies will be intense and will pose for housing officials the cruel dilemma of choosing to help the very poor or the less poor.

9. *Overall.*—These trends spell a substantial increase in the need for housing accommodations but at the same time the imperative of economizing on this increasingly expensive service. For the next 5 to 10 years housing quality is not likely to rise as fast as in the period 1950–1970 and for some families housing payments may take much higher fractions of income than most Americans are accustomed to paying. Studies by the Urban Institute suggest that minority families in particular will suffer from increasing rents and a slowdown in qualitative improvements to housing with perhaps more such families living in inadequate homes in 1980 than in 1970.⁷

⁵ Estimates by the Bureau of Labor Statistics for 1975 adjusted to 1976 by CRS. See U.S. Department of Labor News, 76–759.

⁶ The BLS lower budget for a retired couple in 1975 was \$4,500 and perhaps 5 percent higher in 1976.

⁷ *Housing Low-Income Families: A Summary of Selected Research Products*, compiled and summarized by David B. Carlson with an afterword by Morton L. Isler. The Urban Institute, February 1977, p. 3.

The Nation as a whole can hardly afford to overlook any opportunities to hold down housing costs and outlays. From 1950 through the early seventies the United States followed a strategy of relying heavily upon new construction to raise housing standards. Because of sharply rising costs, this seems less appropriate for the conditions of the next 10 years. More attention is likely to be paid to preserving existing neighborhoods and making more effective use of the standing stock of housing.

Housing choices for the next decade

Housing policies and programs may take 5 to 10 years to put in place and evaluate. In 1976 the Department of Housing and Urban Development was still funding new housing starts for assisted developments under commitments made prior to the Nixon moratorium of January 1973. And the housing assistance program approved by the Congress in August 1974 was so slow in being implemented that a definitive evaluation appeared premature in early 1977. Thus the Congress has more latitude in the consideration of appropriate housing policies and approaches (as distinguished from program levels and incremental adjustments) in a time frame of 5 to 10 years rather than 1 to 2 years.

Among the conceivable strategies are these:

1. A substantial level of new construction for purchase and rental by families who can afford new market-priced housing; others secure accommodations in the existing inventory without significant subsidies for lower income families.

2. A high-volume construction program aimed at meeting household growth requirements, replacing a large number of units removed from the inventory, and providing a sizable quantity of new or substantially rehabilitated housing directly for lower income families.

3. Housing allowance payments for all families deemed to be paying an excessive portion of income for housing due to low income, with average payments pegged to rents or prices of existing housing of modest but acceptable standards.

4. An income maintenance program that applies to all needy families without earmarking of funds for housing.

5. Reduction of housing standards both for new construction and existing houses; permit each household to decide on the quality and amount of residential space it will buy.

6. Combinations of the above.

1. High construction level with filtering down to the poor

This approach—termed a filtering strategy by Anthony Downs—was essentially the one followed in the United States from the end of World War II to the sixties. Housing conditions improved for the majority of families as more units were added to the housing supply than the increase in households. The process was lubricated by substantial tax deductions allowed homeowners but these tax preferences were not generally viewed as “subsidies.”

2. High construction volume for subsidized as well as unsubsidized families

A second approach became official policy in 1968 with the passage of the housing act of that year. Of the 26 million housing units tar-

geted for production over the following 10 years, 6 million were supposed to be earmarked for lower income families requiring subsidy. Through September 1976 about 2.3 million subsidized units were estimated to have been initiated through new housing starts and rehabilitations. HUD accounted for 1.65 million and the Farmers Home Administration for 650,000 units. Another 750,000 subsidized units were projected through fiscal year 1978.⁸ This would bring the total by the end of the 10-year target period to about 3 million, or half the volume called for in 1968.

Had the pace of subsidized housing production in 1971-72 been sustained, the 10-year volume would have come to about 4.5 million units. But in January 1973 President Nixon suspended all new commitments for subsidized housing on grounds that the programs were cost-inefficient. There was opposition to this action in the Congress and the country but not enough to get the HUD subsidy programs fully reinstated. In the view of some observers, a major consideration in the reluctance of some Members of Congress to restore these programs to the targeted levels was their budget impact. One budget expert told a congressional committee in 1971 that the annual payments required to meet the subsidized housing goals set for HUD would be in the order of \$8 to \$10 billion by 1978.⁹

A related factor was the heavy reliance in the principal subsidy programs upon new construction at relatively high unit costs per assisted family. Some housing policy makers, in the Congress as well as in the Administration, were coming to believe that in some local market areas it would be possible to find ample existing standard housing for subsidized families without significantly impacting the market and pushing up rents. Existing units would be available at substantially lower cost and outlay per assisted family than new housing.

Scandal and mismanagement also undermined support for the subsidized housing programs in the early 1970's. To meet high production goals, HUD personnel were forced to sacrifice quality for quantity. In many cases poor sites were approved and shoddy construction was permitted. In connection with subsidized rental developments in financial difficulty, the Federal National Mortgage Association, which held many of the mortgages, blamed poor management and high operating costs, among other factors. The number of subsidized units involved in outright corruption of HUD officials was relatively small, but the smell of scandal tainted the entire program. Amid this swirl of negatives, it was easy to lose sight of the fact that subsidized housing programs are inherently risky and defaults bound to be higher than for market-level real estate.

3. Housing allowances

In any event, the Nation now was urged to move toward another strategy—housing allowances. The idea of housing allowances has appeal to those who place a premium on consumer choice. It also is premised on the belief that housing markets will respond fairly promptly to increased demand without big boosts in housing prices

⁸ Ninth Annual Report on the National Housing Goal, H. Doc. 95-53, p. 39.

⁹ Donald D. Kummerfeld, "The Housing Subsidy System," in papers submitted to Subcommittee on Housing Panels, House Committee on Banking and Currency, June 1971, p. 457.

and rents. In the 1930's the approach was supported by the real estate boards who called for rent certificates as an alternative to the construction of low-rent public housing. In recent years the proponents have included economists and social scientists in universities and research institutes. Congress went along with the idea to the extent of authorizing an experimental housing allowance program in 1970, which is still under way in several places. The housing assistance program—section 8—enacted in 1974 also lends itself to implementation along the lines of a housing allowance approach. Under the portion of section 8 involving existing housing, a participant is free to select any standard accommodation he can find—including his present house if found of acceptable quality and space.¹⁰

The housing assistance program now in force is funded at a level that can assist about 400,000 families a year. Thus it cannot meet one of the criteria of a full-fledged housing allowance program. This is the criterion that all eligible families with incomes below specified levels receive cash or certificates that can be applied toward housing expenses. The general principle is called horizontal equity: All persons in the same circumstances are to be treated similarly. Violation of this principle was one of the main charges brought against the suspended subsidy programs in the National Housing Policy Review ordered by President Nixon in 1973.¹¹ The programs were unfair, it was held, because only a small fraction of the families eligible to participate on the basis of income were being served. The same criticism, unfortunately, applies to the housing assistance program proposed by the Nixon Administration and enacted in 1974. At current funding levels and costs per family, relatively few of the households eligible in terms of income can be accommodated.

The fact is that no housing subsidy program for lower-income families can meet the criterion of horizontal equity unless the Nation is prepared to spend far more than present outlays for assisted housing. The order of magnitude is indicated by estimates for a full-fledged program of housing allowances.

What would it cost to support a full-scale housing allowance program? Estimates prepared by the Urban Institute suggest that as many as 17.5 million households might be eligible to participate but only 40 percent or 7 million households would ultimately choose to enter the program. The average subsidy per household—in 1977 dollars—would be about \$800 a year and total payments would approach \$6 billion a year after a buildup over 3 to 5 years. To this must be added administrative costs of \$1 to \$2 billion a year, for a total cost of \$7 to \$8 billion a year.¹²

4. *Income maintenance*

For those who believe that the "housing problem" is really an income problem, the logical response is an income maintenance program. Give

¹⁰ An analysis of the section 8 program has been prepared in conjunction with this report by Grace Milgram of the Congressional Research Service. The paper is called "The Current State of the Section 8 Housing Programs."

¹¹ Housing in the Seventies, U.S. Department of Housing and Urban Development, p. 112 ff.

¹² The Urban Institute estimates assume no increases in rents resulting from the increased demand, based upon experience with the housing allowance experiment in Green Bay, Wis. If, in fact, rents were to rise by, say, 10 percent, the number of participants might increase to 8 million. Transfer payments to families would then amount to \$7 billion a year. Including administrative costs, the total annual outlay would be in the order of \$8 to \$9 billion. These estimates do not include indirect costs to nonparticipating families as a result of the increased house prices and rents.

people sufficient money and they will meet their housing needs as other families now do in the marketplace. Such a strategy will work only if (a) the income transfers are relatively large so that assisted families will not have to skimp on food or clothing or other essentials, and (b) if the housing markets work effectively for all lower-income people including minority families. Some housing support might still be necessary, such as encouragement of neighborhood rehabilitation, the targeting of special aids to families in really bad housing, and vigorous enforcement of fair housing laws. Whether the Administration is prepared to propose and the Nation to accept a generous income maintenance program may be known within a year or two, in view of President Carter's public commitment to bring out a welfare reform plan.

5. Reducing housing standards

Still another strategy would be to lower standards or expectations for housing. A problem exists only when the community perceives a serious gap between its aspirations in an area like health, employment or housing and present conditions or performance. Lowering expectations reduces the problem to a more manageable level. Many communities did precisely this during and after World War II when housing shortages compelled families to double-up or live in houses with serious code violations. Failure to enforce housing standards in minority neighborhoods and in migrant workers housing is reportedly not uncommon. Thus it is not unthinkable to consider the lowering of housing standards as a way of mitigating the housing problem. But whose standards? It goes against the humanitarian grain of this country to suggest that housing standards be explicitly lowered for the lowest income families while higher income people continue to improve their living environments. Cost trends in housing indicate that the Nation will not be able or willing to maintain the rate of housing improvements over the next decade that characterized the period from 1950 to 1970. But it may not be prepared to adopt a national housing strategy predicated upon acceptance of housing standards for lower income people that are markedly and visibly below levels generally deemed acceptable in the community.

Issues in program design

Policy designers do not start with a clean slate. In weighing an appropriate national housing policy for the future we need to consider previous commitments, experience with earlier programs, and budgetary and institutional means available. It would be foolish, for example, to set a production target for housing so high that prices or rents would rise by 25 percent a year: it would be futile to lay out a set of programs that require a level of managerial or administrative competence far beyond what Federal agencies or local governments have been able to achieve. Ends must be adapted to means just as means must be shaped to carry out realistic goals. Some of the issues involved in this meshing of means and ends are set forth below.

1. *What is the main objective?* Is it to save older neighborhoods? To widen the range of housing choice of lower-income families? To stabilize the homebuilding industry by guaranteeing a steady level of support for new assisted housing? To assure that households with insufficient income are able to afford adequate houses? If the last of

these is taken to be the major purpose of Federal housing policy, another set of questions suggest themselves.

2. *How many households need help?* The Urban Institute says that 17 to 18 million households would qualify for assistance. The estimate excludes nonelderly single person households and those with substantial assets. Low-income homeowners—many of whom are elderly—as well as renters would be eligible. As noted earlier, half or more of the eligibles might decline to participate.

3. *What standards will be applied?* It is generally agreed that housing for which subsidies may be paid should be modest but structurally sound and adequate in terms of basic facilities such as kitchens and bathrooms and with sufficient space for the size of family. Localities participating in the section 8 housing assistance program utilizing existing housing have apparently not had great difficulty in setting standards, although complaints that HUD has not permitted sufficiently high fair market rents may cloak disagreements about acceptable quality of housing. In fact, there may be serious difficulties if one looks at the whole bundle of residential services made available to the family rather than the house alone. Should minimum standards be set for the quality of community facilities and services? The caliber of the schools? Access to recreation and open space? Adequacy of public transportation? These problems are not insuperable if the test of reasonableness is used. But there may be genuine differences of opinion between local officials and representatives of the low-income community both as to standards initially established and adequacy of enforcement. This suggests the need for systematic monitoring by Federal personnel to make sure that Federal assistance is not simply being siphoned off by landlords of substandard rental properties.

If the main objective of Federal assistance is as stated above, the housing occupied by subsidized families need not be new. But if new construction is deemed necessary due to real shortages of adequate housing in the community, standards for new units will probably be set in terms of location, concentration, amenities, and costs. A guiding principle is to recognize that the newly built structures have to yield acceptable housing services over a long period of years. Maintenance and operating costs over time have to be considered, not just initial construction costs. And while the construction need not be luxury quality, it may be false economy to omit facilities deemed essential in market-level developments, such as central air-conditioning in areas with long hot and humid seasons.

4. *Existing versus new housing or both?* From a cost standpoint, existing housing has an advantage over new construction. Families assisted in existing housing under section 8 in fiscal year 1976 required average subsidies of \$2,200, compared with \$3,600 in new or substantially rehabilitated units. Estimated subsidy payments in fiscal year 1978 will be \$2,200 for existing units and \$4,000 in new units. (Inclusion of income tax preferences would significantly increase Federal costs for new section 8 construction, particularly if financed by State housing finance agencies with tax-exempt bonds and sponsored by limited-return corporations or partnerships.)¹³

¹³ See "Comparative Costs of Housing Low-Income Families Under Several Federally Assisted Programs," by Morton J. Schussheim, Senate Committee on Banking, Housing and Urban Affairs, June 1976.

In addition to lower unit costs in existing housing, the contract commitment can be of far shorter duration than in new construction. And with such assurances as are necessary to induce private owners to rent to assisted families, such as reimbursement for a limited period as a result of the tenant leaving before the lease has expired, the benefits can be tied to the family, not to the unit.

There is, of course, the possibility that rents will be driven up as a result of a leased-house program involving existing housing. Not only would program participants (and therefore the Federal Government) have to pay more, but other families ineligible for subsidies or unwilling to take them would also be adversely affected. The experimental housing allowance program in several cities indicates that rents do not rise significantly but it may not be prudent to generalize from this experience. Rents could be pushed up if a higher proportion of eligible families were able to participate and chose to do so. And for particular types of households, such as families requiring three or more bedrooms and minority families, the rental supply may be inadequate or unresponsive. In at least one city with an experimental housing allowance program—Jacksonville, Fla.—black households encountered unusual difficulties. The percentage of black enrollees in Jacksonville who were able to receive benefits was much lower than nonminority enrollees. There were two reasons, according to the Urban Institute: many of the houses occupied by blacks were low-quality so the families could not receive payments in place. Second, it was difficult for black families to find other housing that met program standards. The city's housing markets are sharply segregated, and black families were evidently reluctant to seek acceptable housing outside their neighborhoods.¹⁴

When there are serious housing shortages for particular segments of the population, new construction for subsidized households may be the appropriate response. If new construction is undertaken, the lessons of the recent past with subsidized rental developments must not be forgotten. Are the proposed sites suitably located and serviced and potentially attractive for market-level housing as well as for subsidized families? Have allowances been made for the probability of rising operating expenses? Do the interested sponsors and builders have a record of long-term commitment to stay with their developments? Or do they appear primarily interested in immediate profits on land and construction and the sale of portions of the equity as tax shelters to high-income investors with nonrelated income? Do the sponsors have experience in the management of rental housing occupied by subsidized families? If not, what arrangements have been made to retain competent management? These are some of the questions that prudent program administrators will ask.

5. *Is there a rationale for shallow subsidies?* This type of assistance is aimed at lower middle income and working families who presently cannot afford better housing at current market prices. Programs of this sort generally provide interest subsidies or reduced mortgage payments for a period of time to enable certain families to buy homes. If such assistance is to be provided, it may be wise to limit it to relatively strong families with good credit patterns and good prospects

¹⁴ Carlson and Isler, *Housing Low-Income Families*, op. cit., p. 28.

of raising their incomes. Home ownership for very low income families with no prior experience with this form of tenure is risky not only for the Federal Government but for the family itself. Earlier program experience suggests that the very poor do not have the resources to cope with home ownership expenses. The upward trend in operating expenses will make it even more difficult for the poor.

The home ownership assistance program known as section 235 was able to reach down to families with incomes of \$4,000 to \$5,000 in the early 1970's in some parts of the country. At today's development costs and operating expenses it requires an income of \$10,000 to \$12,000 even with a 1-percent interest rate. In the view of some housing experts the program now has to be seen as a lower middle income housing vehicle. To make the program work in all parts of the country present mortgage ceilings will have to be raised.

If there is a congressional determination to serve lower income families through this program, say families with incomes as low as 50 percent of median income or about \$7,000 in 1976, methods of deepening the subsidy need to be found. Among the possibilities are a zero percent rate of interest, capital writedown to reduce mortgage payments, and/or subsidies to cover uncontrollable expenses such as property taxes and hazard insurance.

Other measures may also be indicated. Counseling services, authorized by the Congress but never fully implemented, could help lower income purchasers with income budgeting, home maintenance, and related problems. To avoid defaults resulting from unanticipated major repairs for which the owner cannot pay, HUD might be authorized to make loans on lenient terms or to make payments under its mortgage insurance contract. And a procedure could be established under which a section 235 homeowner could transfer the property to another eligible family. This might reduce the number of homes that are abandoned when an assisted family must move and cannot find a market-rate purchaser.¹⁵ It may be noted that the Farmers Home Administration manages to keep the foreclosure rate low on its interest subsidy home ownership program (section 502) by substituting one family for another that cannot meet its obligations.

Some knowledgeable observers believe that a degree of lender risk should be required in connection with a subsidized homeownership program involving lower income families. Perhaps a less-than-100 percent mortgage insurance coverage by HUD would induce a degree of lender prudence and discretion not previously exercised. The differential might be taken up with coinsurance, although private insurers might turn down properties in higher risk areas of the city. However it is done, measures seem to be indicated to prevent the practice of mortgage initiation and mortgage assignment at the expense of the FHA.

Other proposals to close the gap between moderate incomes and homeownership costs also need to be approached with considerable caution. The general design of most of these proposals is to help first-time buyers of homes by shifting part of the payments on a loan

¹⁵ Some of these suggestions are taken from a paper prepared by Philip N. Brownstein under a contract with the Congressional Research Service. The paper is titled "Evaluation of the HUD Section 235 Subsidized Housing Program." A companion paper by the same consultant relates to a rental subsidy program and is called "Evaluation of the HUD Section 236 Subsidized Housing Program."

from the early years to later years. The ability to meet higher monthly payments in later years is predicated upon the family's income rising over time. Under some plans the amount of mortgage debt actually rises in the early years; if a family finds itself compelled to sell earlier than anticipated, it can end up owing more money to the lender than it originally borrowed. The more promising approaches in this group involve some form of low interest or noninterest-bearing second mortgage, repayment of which might still leave a net gain in equity to the home buyer. An experiment along these lines is being tried in Dade County, Fla.¹⁶

This class of subsidies is likely to be helpful to families with incomes between \$15,000 and \$20,000 a year or higher. They are not appropriate for low-income families. They may be of some help to low-income families, however, to the extent that the submarkets of lower priced and lower rental housing are loosened up.

6. *What is the role of rehabilitation?* Rehabilitation of housing can range from moderate fixup to gutting and complete reconstruction. The appropriate level of rehabilitation will depend upon incomes and types of families to be served, location and age of properties, and costs compared with new construction (including streets, utilities and other supporting facilities). What we are mainly concerned with here is the potential of rehabilitation for lower income families in their present neighborhoods or areas to which they might gain access. Rehabilitation is important in its own right as a means of extending the economic life of the supply of existing housing. It may also be helpful in improving the housing conditions of lower income families but it is not the only vehicle for this purpose.

For several decades housing officials have seen in rehabilitation an approach of considerable potential but accomplishments have fallen far short of the promise. In laying out the national housing targets, for example, the first goals report of 1969 projected 2 million assisted rehabilitations over the next 10 years. The second goals reports reduced the target to 1 million units and said that even this level would be difficult to achieve because of limited entrepreneurial capacity for rehabilitation.¹⁷ The ninth goals report issued in January 1977 estimates that 274,000 units of subsidized housing were actually begun between 1969 and September 1976 with the possibility of another 100,000 by the end of fiscal year 1978. One-third of the subsidized rehabs, it may be noted, have come through programs of Farmers Home and the balance are attributed to HUD programs.

The volume of activity is not the sole measure of a program's success or shortfall. One must also consider how long the improvements last, the consequent living conditions of the residents, and the effects on other properties in the vicinity of the rehabilitation.¹⁸ While rehabilitation holds promise, past experience must make us cautious about expecting too much or settling on one particular approach or level of rehabilitation. A check of rehabilitation efforts conducted in

¹⁶ A number of such proposals are analyzed in a paper prepared for the Congressional Research Service by Frank S. Kristof, "Proposed New Types of Home Mortgage Instruments." This report draws on Dr. Kristof's paper.

¹⁷ Second Annual Report on National Housing Goals, H. Doc. 91-292, p. 25.

¹⁸ This section draws on a paper by M. Carter McFarland, "The Rehabilitation and Revival of Decayed or Decaying Residential Neighborhoods." The paper was done under a contract with the Congressional Research Service. A memorandum on the same subject by Michael Agelasto of the Congressional Research Service was also helpful.

four cities with HUD support 7- to 10-years-ago presents a sobering picture. In all four cities—New York, Boston, Pittsburgh, and Detroit—the rehabilitation outlays were substantial, ranging from \$8,000 to \$18,000 per unit on top of acquisition costs of \$2,000 to \$5,000 per unit. (Rehab costs for comparable work would be much higher today.) In none of these cities was the rehabilitation a financial success. In all of these cases the mortgages on practically all of the rehabilitated structures have been foreclosed or assigned to FHA. Perhaps the best report is for Pittsburgh's effort:

"After 9 years, the experience is mixed. A good deal was accomplished, several thousand families were given better homes and many minority contractors and workers were given training and jobs. On the other hand the experiment did not prove profitable to the company partly because some families were destructive of their housing and failed to pay their rent and partly because a more flexible and generous Federal subsidy would have been needed."¹⁹

For other cities, reasons for failure range from a small percentage of destructive families (Boston), to unsuitability of the structures for rehabilitation (New York's Old Law tenements) and insufficient scale to create its own environment (New York), to overestimation of the market for small rental units (Detroit).

Today there is a resurgence of interest in rehabilitation. A considerable amount of neighborhood fixup is taking place in various cities with funds from Community Development Block Grants. It is still too early to speak of lasting results, but local and national officials are optimistic about these efforts.

Concurrently there are related activities under the rubric of homesteading. Publicly acquired properties are being transferred to new owners on condition that they will be fixed up and occupied by participants. It seems clear that this must involve credit-commanding middle-income families, even if the properties are turned over for \$1. The reason is that the new owner must be able to secure a loan or have savings to undertake \$15,000 to \$30,000 or more of work to fix up his "homestead."

By and large, rehabilitation of owner-occupied houses has been more successful than of rental properties. This probably reflects the higher incomes and social patterns required for home ownership. It may also work better in neighborhoods or communities that are relatively cohesive and where people are concerned about each other. Thus, neighborhood rehabilitation may tend to reinforce ethnic or racial boundaries. Since fair housing is a matter of national concern and law, local officials must be prepared to reconcile this social objective with neighborhood preservation efforts.

In selecting neighborhoods for rehabilitation, the dominant view today is to give priority to areas that are in early stages of disrepair rather than deep decline. Caught in time and with the proper infusions of public improvements, private credit, and resident participation, many older neighborhoods can probably be stabilized and kept livable for the next 10 to 20 years or longer.

The toughest problems in rehabilitation have to do with low-income renter families in the inner city. In such districts, rehabilitation may

¹⁹ McFarland, *op. cit.*, p. 22.

have to include not only repairs to houses but improvements in municipal services, efforts to find jobs for the employables, and social services to families. Grigsby's studies in Baltimore suggest that inner city tenants are realists: they ask for better police protection, more frequent garbage pickups, and more play space for children rather than sumptuous improvements to their houses.²⁰ Rehabilitation of the houses in such areas probably should be limited in type and moderate in cost.

7. *Block grants for housing.* Is this an idea whose time has come? Former HUD Secretary Carla Hills apparently thought so in the summer of 1976 and instructed her staff to design a program. The Ford budget issued in January 1977 proposed that section 8 funds be allocated in line with such a concept.²¹ If approved by the Congress, budget authority would be allocated directly to the communities. Local officials would decide on the appropriate mix of new, existing, and substantially rehabilitated housing as determined in their housing assistance plans. The HUD proposal reflects congressional intent expressed in the Housing Authorization Act of 1976 that HUD distribute section 8 funds to the extent practicable in accordance with local housing assistance plans.

Under a block grant approach, Federal funds would be distributed by formula to local governments to enable them to carry out a broadly stated Federal purpose. Local recipients would decide how to spend the money in accordance with local priorities as spelled out in some sort of plan. They would not have to obtain Federal approval for individual projects or activities. The Federal department in charge of the program would confine its role to such oversight as necessary to assure financial integrity and program conformance to the local plan and to keeping Congress advised as to progress, problems, and costs of the program. There would also be Federal enforcement of relevant laws such as fair housing and nondiscrimination in employment. The essence of a block grant concept is that local officials and technicians set priorities, choose strategies, and determine specific projects and undertakings with minimal Federal participation.²²

There are many considerations in the formulation of a block grant for housing such as the scale of the program, the range of permissible activities, and the Federal programs it would or would not replace. These have been spelled out elsewhere.²³ A congressional decision to adopt such an approach would seem to turn on at least three crucial questions:

1. Would national purposes and priorities be properly served under a housing block grant system?
2. Can assisted housing be adequately funded through block grants?

²⁰ William G. Grigsby and Louis Rosenburg, "Urban Housing Policy" (APS Publications, Inc., Center for Urban Policy Research, Rutgers University, 1975), pp. 93-95.

²¹ That proposal was not included in the revised budget submitted by the new administration.

²² This report draws substantially upon a monograph prepared under contract with the Congressional Research Service by John M. Frantz entitled "The Use of Block Grants as a Vehicle for Federal Housing Assistance."

²³ The Frantz study, cited above, is the most recent and perhaps most comprehensive analysis.

3. Do local governments have the competence to develop strategies and implement a broad-gauged program of this type in the complex field of housing?

It is in the nature of local politics that funds for community improvements and housing will be spread widely. Every district and every ward will want some of the Federal money. Funds may be spread too thinly and without particular attention to the needs of the most deprived sectors of the population. This is a finding of several studies with respect to the community development block grant program. There is no reason to think it would not be the same with a housing block grant program.

Second, there is the question of funding. Relatively large numbers of families are now assisted under annual contracts between a sponsor and the Federal Government. Would the Congress be prepared to convey to 2,000 or more localities the power to commit the Federal Government to make payments for assisted housing over 30 or 40 years? If not, the alternative is full funding of all projects. That is, the locality could only make agreements to the extent of funds in hand. This would seem to limit activities to one-time payments or relatively short-term assistance or to needs that can be met with comparatively thin subsidies.

Third, there is the question of local administrative competence. This matter requires more information than is available. Some observers who are familiar with local efforts to administer such programs as Model Cities, urban renewal, and local economic development, among various federally assisted local enterprises, have expressed doubts that local governments as a group currently have the institutions and personnel to carry out effectively and efficiently a housing block grant program.

8. *Should localities be required to share in housing subsidies?* Most Federal programs require the recipient to share in the cost of the program or project.²⁴ The trend, however, has been toward a lowering of the local share: 90-percent grants are increasingly common in social welfare programs such as the adult education program and the older Americans community service employment program. Congress considered a 90-percent Federal and 10-percent local sharing for the Community Development Block Grant program adopted in 1974 but finally settled on a 100 percent grant. Housing assistance programs have generally not required local sharing, but the low-rent public housing program does require localities to accept a payment in lieu of property taxes by the local housing authority that is usually lower than the property tax that would otherwise be imposed on a public housing development.

A strong case can be made for local participation in the cost of federally assisted programs. The following arguments have been offered:

1. A local contribution demonstrates the locality's commitment. Free money may be accepted even if the community places a very low priority on the undertaking.

²⁴ This section draws upon a memorandum prepared by Barbara Maffel of the Congressional Research Service called "Should Local Governments Be Required To Contribute a Portion of the Total Cost of Federal Housing Programs?"

2. The programs are expensive and local taxpayers should be called upon to share the costs.

3. It makes for closer supervision and better management if localities have some of their own money in an activity.

Against these views it is argued that if a local contribution is required some communities, for lack of funds, will have to turn down Federal assistance for activities on which the Nation puts a high premium. For example, toward the end of fiscal year 1975, \$5 billion in grants from the Environmental Protection Agency reportedly were unclaimed mainly because of a lack of matching funds. Federal funds have also gone unclaimed for hospital construction, maternal and child health, and similar programs. Matching requirements may thus discourage financially pinched communities from participating fully in socially desirable undertakings. They may also work a particular hardship on groups in a community with little political influence—the under-educated, the poor, and minority people.

Housing for lower income people has generally had little community support. The only exception is housing for the elderly. A requirement that localities share in the cost of such subsidies—particularly in the form of a cash contribution—would probably result in a number of places declining to participate in subsidized housing programs.

An alternative is to offer supplementary grants to localities that utilize a designated portion of their general funds for subsidized housing. The Secretary of HUD would have a discretionary fund from which such grants could be made. Localities might thus be encouraged to allocate a larger share of their general revenues (including monies received through the Federal general revenue sharing program) to housing for lower income families.

9. *Can housing programs be administered more effectively?* There is widespread dissatisfaction with the administration of housing programs in the United States.²⁵ Carping about inefficiency and waste in government is a cherished tradition in democratic societies, but it has a special shrillness in this country when directed to programs that are supposed to help the poor. Certainly this is true in connection with subsidized housing. Residents will invariably oppose location of a public housing "project" in a pleasant neighborhood; later, when it has been sited in a ghetto or near the city dump, people will point to the ill-starred development as another example of government bungling.

How do we get an administrative agency to implement effectively a policy or program? "Three conditions must obtain. First, the agency must identify with the goals of the policy. Second, there must be clear communication of what the top officials really want. Third, a penalty and reward system must be available to back up the official policy. Outside the administrative apparatus, the intended beneficiaries of a program must be convinced that real benefits will be forthcoming, and the community at large has to be persuaded that the policy or program is needed and is worth the cost".²⁶

²⁵ This section has drawn upon a paper by Francis Parente of the Congressional Research Service entitled "Housing Management Problems Survey."

²⁶ Morton J. Schussheim. "Toward a New Housing Policy: The Legacy of the Sixties" (Committee for Economic Development, supplementary paper No. 29, 1969), p. 46.

If the Department of Housing and Urban Development has been a troubled agency in recent years, its difficulties may be partly explainable in terms of the criteria stated in the preceding paragraph. The appointed officials who took over HUD in 1969 were charged with implementing programs called for by a different administration. The incumbent administration in the Executive Office of the President exhibited growing doubts about the value of the housing programs that culminated in their wholesale suspension by Presidential order in January 1973.

Civil service personnel may not have been clear on what the top officers of the Department really wanted. In the early years of his tenure, HUD Secretary George Romney was known as a production man and the Department responded by approving record numbers of subsidized housing and insuring many properties in risky areas. But in early 1972, with many loans going sour, the Secretary in testimony before a congressional committee cited a number of factors including "excessively zealous implementation of congressional mandates to insure mortgages on inner city housing for the poor."²⁷

Another problem has to do with institutional missions and viewpoints that transcend in time the comings and goings of different administrations. Prior to the 1960's the Federal Housing Administration had little responsibility for low-income housing. Its main mission was to insure housing mortgages on properties sold or rented at market prices. FHA viewed itself as a self-sufficient insurance agency that could function with little or no support from the taxpayers. The decision to assign FHA responsibility for subsidized housing programs and to write insurance on properties in declining neighborhoods was met with opposition by mortgage bankers and other groups with which FHA did business. And for some FHA personnel the instruction to move into subsidized housing and depart from the canon of economic soundness as a basis for underwriting mortgage loans seemed to be inconsistent with everything the agency had stood for.

Today FHA is a shadow of its former self. In 1976 FHA insured 5 to 6 percent of new homes sold and 7 to 8 percent of existing homes sold. It is submerged within HUD without clear lines of authority to the field and under an assistant secretary only one of whose duties is to run the agency. It may be unwise to try to restore FHA to the dominant role it once played in residential finance, but some people believe that it could have a constructive part in meeting housing requirements. A starting point would be to clarify its mission and assign the agency a consistent set of functions. Looking at FHA's achievements as well as shortfalls, some housing experts have suggested that the agency be reconstituted to serve first-time homebuyers, rental housing, and credit-short areas but not necessarily have a prominent role in dealing with the housing needs of low-income families. In helping to increase the supply of housing for middle- and moderate-income families, however, FHA would be loosening markets to some degree for lower-income families.

²⁷ Testimony of Secretary Romney before the House Committee on Banking and Currency, Subcommittee on Housing, hearings on real estate settlement costs, Feb. 22 and 24, 1972, p. 57. The statement was in connection with problems in Detroit, Mich.

In seeking to improve the effectiveness of HUD programs, it may also be useful for the Congress and the Administration to examine the many social requirements imposed on HUD's housing programs. These include environmental reviews and impact statements, reviews for consistency with areawide planning (A-95) by councils of governments or other agencies in metropolitan areas, payment of prevailing wages to construction labor (Davis-Bacon Act), and similar provisions of law or administrative regulation. Each of these requirements presumably has a social priority in its own right. But housing has proven a frail vessel for the carrying of so many social goods. Moreover, when there are alternative ways of securing financing or other forms of Federal help without complying with all these requirements, builders and borrowers will seek the less burdensome and time-consuming sources. The decline of FHA volume is in some measure attributable to the more stringent requirements of this nature enforced with respect to its programs as compared with conventional financing.

If public housing and leased private housing programs are to have a substantial role in assisting lower income families, more attention will need to be directed not only to HUD's administrative practices but also to the structure and functioning of local housing organizations. In the last half dozen years operating expenses of public housing agencies have climbed at a sharp rate and necessitated increasing amounts of Federal payments toward such expenses. The fiscal year 1978 budget requests authority to obligate \$665 million for this purpose. Studies done for HUD by the Urban Institute have identified certain characteristics of high performance housing agencies. These include strictness in enforcing rules, quick response to tenant problems such as clogged toilets, involvement of tenants in rule-setting, and decisionmaking at the project site rather than the central office.

If effective use is to be made of existing housing, local housing machinery will have to be improved. Local public housing agencies (PHAs) have principal responsibility in connection with section 8 existing housing. An effective PHA will establish outreach communication with landlords and prospective program participants. It will also be in close touch with real estate groups, tenant organizations, and public agencies such as the building inspection department and welfare agencies.

Alternative or supplementary local delivery mechanisms may also merit consideration. It might be possible to develop a program that would attract participation by private rental agents and property management firms. Perhaps they could be licensed by city hall or HUD or both. To reach the full market potential of the existing housing program, a broadening of the delivery system along these lines may be indicated.

For the program to be attractive to landlords, rents must be realistically set. One of the major administrative difficulties of the existing housing section 8 program, according to the General Accounting Office and other observers, has been the use of fair market rents. The fair market rents are intended to protect the tenant and the government from overcharge, preclude occupancy of luxury houses, and control program expenditures. In practice they have been unwieldy and cannot be changed quickly to adapt to altered market conditions. Their use as

a means of budget control may prevent correction of original miscalculations or adjustments reflecting market changes. An alternative approach would be a maximum limit upon the subsidy to be paid, say, not to exceed the maximum amount payable for newly constructed conventional public housing in the locality. Administrative controls could prevent use of luxury housing.

A balanced approach to lower-income housing

Housing policy emerges from the political process. It may be informed by technical analysis but there is no single definitive solution that analysts can determine for the housing problem. The larger questions about housing have to do with income distribution, stabilization of the economy, equal opportunity, and environmental protection. On such matters, the Congress and the Nation are often faced with difficult choices among several good social objectives, and the decisions are ultimately made not through technical calculation but value judgments.

In rethinking national housing policy for lower-income people, it may be useful to have some guiding principles and facts before us.

1. We must be concerned with providing adequate housing services over time. Like other forms of capital investment, housing is valuable only to the extent it yields a stream of income or amenities over a period of years. Producing a given number of new or rehabilitated housing units in any one year is only the beginning of the process; the structures must be properly occupied, operated, and maintained.

2. A corollary of the first point is that we cannot afford subsidized housing programs that permit developers or sponsors to build and run. Rental housing for lower income households, especially families with children, is difficult to operate and maintain. Experienced and committed sponsors are called for. Local housing authorities have a long-term responsibility. Some private sponsors bring a long-term commitment to their developments. But HUD has found it necessary to take back many mortgages or properties within 3 to 5 years of construction. The department's inventory of acquired properties and assigned mortgages in multifamily structures totaled more than 250,000 units in January 1977. Over two-fifths (43 percent) of these defaulted properties were financed under subsidized programs (section 236, 221 (d) (3) BMIR, and 221 (d) (4) with 100 percent rent supplements).

3. Location of housing is central to its long-term value. Sturdy buildings in undesirable locations are bound to be less valuable than those in good locations from a social as well as investor viewpoint. Poor sites have been a principal reason for the failure of a number of subsidized developments.

4. Housing is costly. There is no cheap way at present to provide large numbers of low-income families with adequate housing within their means except by overlooking their problems. For example, under the section 8 program involving new or substantially rehabilitated units, the direct subsidy per family in fiscal year 1978 will average about \$4,000 per year; with existing housing, it will average \$2,200 a year.

5. Housing subsidies are a form of income redistribution. The principle of equity suggests that all households who are eligible for assist-

ance should be able to avail themselves of the help. If the subsidies were to take the form of housing allowances primarily utilizing existing housing, Federal outlays after a buildup over 3-5 years could range between \$7 and \$9 billion a year.

6. A balanced housing assistance approach for lower-income families will probably require both new and existing housing. This is recognized in the programs authorized by Congress in 1974—the section 8 programs. In some types of market situations and for certain types of households, new construction may be required; in others existing housing may suffice. There is a *prima facie* case for making do with existing housing where the supply is ample and in good condition. But program administrators have to keep a close watch to be sure rents are not shooting up as a result of the subsidy program. This could happen if many of the assisted families need large units, which tend to be in short supply, or if the housing markets are sharply restricted against minorities by discriminatory practices.

7. Special incentives may be necessary to induce housing managers—public and private—to accept a fair share of the lowest income families. Housing managers will normally give preference to the less poor rather than the lowest income families among the eligibles since the poorest are considered more difficult tenants and less able to absorb future increases in operating expenses.

8. Home ownership is an expensive proposition and getting relatively more so. If it is pressed upon low-income families with slim prospects of raising their incomes at the rate of general price increases, severe problems are virtually inevitable. By and large, if home ownership assistance is available, it would be unrealistic to bring in families with incomes below \$10,000 a year.

Some near-term implications

This section presents some implications for housing policy and programs over the next year or two. The issues include programs levels and emphasis and program administration within the framework of housing policies previously established by the Congress. The new Administration has not had sufficient time to formulate and propose major new policy directions for housing. The revised budget submissions do, however, reflect some changes in emphasis that are noted in this report.

1. *Program levels.*—The Department of Housing and Urban Development is now projecting total reservations of assisted housing of approximately 500,000 units a year in both 1977 and 1978. Within these levels, 400,000 units would be rental housing funded under section 8 and public housing and 100,000 units would be for home purchase under the revised section 235 program. The totals are within the numerical targets for assisted housing set by the Congress in 1968—6 million assisted units over a 10-year period.

How many of these reservations will be translated into occupied units over the next 3 years remains to be seen. In the past several years HUD has consistently fallen behind its own estimates. The fiscal year 1976 budget estimated that 140,000 units would be made available for occupancy under section 8 and public housing that year; the actual number, as reported in HUD's most recent budget justification, March 1977, was less than 62,000 units.

While the need for assisted housing is great, HUD might be well advised to set reasonable targets and to build up the volume of assisted housing in a deliberate manner. There are good reasons for avoiding a crash program. The forced-draft production levels of 1971 and 1972 permitted a number of projects to be approved in poor locations, with questionable management commitments, and based on underestimates of future operating expenses. HUD may presently lack staff capacity to handle a big increase in processing and supervision of assisted housing. With private housebuilding activity on the rise, there are potential inflationary effects on construction and land costs from large additional injections of new housing. Not least, we need to think about the housing after it is built and to assure that localities and sponsors assume a long-term view of their responsibilities for the housing developments and the neighborhoods in which they are located. Tenants, too, have responsibilities.

2. *The mix of new, rehabilitated and existing housing.*—The 1976 Housing Authorization Act requires HUD to allocate assisted units among new, rehabilitated, and existing housing to the extent practicable in accordance with local housing assistance plans. Prior to this statutory change, the previous Administration was pressing localities to rely primarily upon existing housing in utilizing the section 8 program. Now the pendulum is swinging in the other direction, with housing assistance plans calling for 57 percent of the assistance in the form of new or substantially rehabilitated houses. At the present time the Congress has no assurance that the mix reflected in the local plans constitutes the most effective and least costly way of meeting the housing needs of lower income families. New and substantially rehabilitated houses require annual payments that are almost twice as high as existing units. Where market conditions are favorable, a good case can be made on cost grounds to utilize existing units. It is possible that more families could be helped with a given amount of Federal outlay.

A small technical amendment might increase the effectiveness of the Federal aid while continuing to give localities the lead role in determining the mix. Language could be considered that would require that the Secretary of the Department of Housing and Urban Development, in approving housing assistance plans, find that the locality is proposing to utilize the least expensive and most effective combination of new, rehabilitated and existing housing, taking into account both immediate and longer-term effects upon the quality, composition, and prices of the existing inventory of housing and consequences for non-participants as well as participants in assisted housing.

3. *Moderate rehabilitation under section 8.*—The legislation and administrative procedures governing section 8 appear to recognize only one possible level of upgrading of existing housing: substantial rehabilitation. Unit costs for substantial rehabilitation under section 8 are running as high as new construction. Moreover, substantial rehabilitation may result in displacement of tenants from previously occupied properties. Moderate rehabilitation has been encouraged under several HUD programs; it may be a way of enlarging the supply of modest but acceptable existing housing for section 8 families. HUD could be authorized to utilize such improved properties under section 8 and instructed to develop effective approaches of this type.

4. *Moderate rehabilitation through public acquisition.*—Another way of fostering moderate rehabilitation is through the public housing program. Local public housing agencies could be encouraged to acquire properties that require some improvements but not complete reconstruction. "Acquisition—with or without rehabilitation" is the handle for a HUD program that could be activated for this purpose. If modest improvements or modernization were required, funds would be available for this purpose. To the extent feasible from a management standpoint, houses would be acquired in a number of different blocks and neighborhoods to avoid overconcentration of subsidized families and the moving out of unsubsidized families.

5. *Role of public housing agencies.*—The new administration's revised budget proposes to place more reliance upon local public housing agencies for conventional or turnkey public housing. The Ford budget proposed no additional reservations of public housing units in fiscal year 1978; the Carter budget calls for 50,000 units. Studies by the Urban Institute suggest that a number of PHA's have the capacity to expand their programs, particularly those in middle and smaller sized communities. Unit costs are also somewhat lower than for privately sponsored developments under section 8 for the same income levels. As of mid-1976 there were more than 2,800 public housing agencies with a total of almost 1.2 million units under management. The average income of public housing tenants in 1976 was about \$4,200. The PHA's have a substantial function in housing the poor both in managing and increasing their own projects and administering the section 8 program in connection with existing housing.

6. *Metropolitan-wide housing opportunity plans.*—HUD has been giving bonuses of 10 percent or more above normal allocations of section 8 units to communities that have agreed to participate in area-wide fair share housing plans. This practice appears to be an effective way of carrying out the spirit of the Fair Housing Act and congressional intent with regard to metropolitan cooperation. If the Congress approves of this approach, it may want to clarify its endorsement in relation to the 1976 amendment requiring distribution of section 8 funds in accordance with local housing assistance plans.

7. *The loan management inventory and section 8.*—In 1976 HUD commenced to provide section 8 assistance to certain financially troubled rental developments with mortgages insured or held by the Department. By the end of September 1976, such help had been extended to developments containing 111,448 units. The Department indicates in its budget proposals for fiscal year 1978 that an additional 55,000 units might be similarly assisted. This action has been criticized on two counts: first, as a bailout of projects that would otherwise add to the already large inventory of HUD-held properties; second, as a displacement of units that were intended to help previously unassisted families under section 8. Several questions may be asked about this practice. Why has HUD been reluctant to use authority and funds to assist section 236 projects with financial difficulties associated primarily with rising property taxes and utility costs? Admittedly, this is not a general solution for all of HUD's financially troubled developments, but it could help with some. Second, what are the prospects for restoring various properties in the loan management portfolio to economic viability with and without additional payments? A thorough

examination and report to Congress by the Department on the loan management inventory would seem to be indicated.

8. *Is section 235 workable? For what income groups?*—HUD proposes to raise the mortgage limits on section 235, the home ownership assistance program, and make reservations of 100,000 units a year in 1977 and 1978. Fewer than 19,000 units were reserved under section 235 in 1976 and the transition quarter and less than 600 units started. This may be attributable to the relatively low mortgage ceilings applicable to the program that precluded its use in many parts of the country. With the new mortgage limits and interest rates subsidized down to 5 percent—plus .7 percent for mortgage insurance premium—homebuyers without previously accumulated equity or other resources will need incomes between \$14,000 and \$18,000 to participate. For most families with incomes below these levels to participate, it would be necessary to deepen the subsidy.

9. *Getting a handle on housing costs.*—Both construction costs and operating expenses for housing have risen faster than prices generally over the past half dozen years. More recently, with housing activity starting to pick up, lumber costs at wholesale jumped 24 to 30 percent in 1976 and are expected to increase another 25 percent in 1977. Land prices, fees, and other costs are rising as well. Perhaps it is time for another thorough assessment of the factors contributing to rising housing costs and consideration of ways to arrest these trends. HUD could be directed to carry out such a study. Alternatively, a national commission might be established for this purpose.

10. *What marching orders for HUD?*—The Department of Housing and Urban Development is cast in the role of a David facing Goliath-sized problems. It is expected to stabilize construction activity but has little or no role in formulating the fiscal or monetary policies that can send housing into a slump. The department has lacked the tools and the funds to restore decaying neighborhoods. And its resources have been limited to dealing with the housing needs of lower income people. Still, there is much that HUD can do in the next several years. And the Congress can help by clarifying its priorities.

There is considerable support for the view that our national policies should place a high priority on preserving neighborhoods and the existing housing supply. More attention could be given to HUD's performance as a conservator of older neighborhoods. The Department's success in dealing with its own large inventory of assigned mortgages and acquired properties would be another measure of effectiveness. Perhaps less emphasis should be placed on the numbers of assisted housing starts attained in the next year or two. Certainly there is need for additional volume. But it may not be helpful to push HUD into a numbers game. The new leadership needs time to strengthen the administrative capability of the Department. It also needs a clearer sense of its missions. To consider and clarify missions is the responsibility of the Congress.

THE CURRENT STATE OF THE SECTION 8 HOUSING PROGRAMS
(By Grace Milgram, Specialist in Housing, Economics Division)

BACKGROUND

The leased housing program was established in Title II of the Housing and Community Development Act of 1974, as Section 8 of the amended United States Housing Act of 1937. It is currently the primary instrument for the provision of housing assistance to households with incomes too low to obtain decent housing in the private market. It is an outgrowth from the section 23¹ leasing program under which public housing authorities leased units in privately owned housing and sublet them to households eligible for admission to public housing.

Section 8's adoption followed the suspension in January, 1973, of the section 235² home ownership program, the section 236² moderate-income rental program, the rent supplement program, and the low-rent public housing program, which together had formed the major Federal housing subsidies for moderate- and low-income households. Thereafter, the only projects eligible for assistance under these programs were those for which earlier commitments had been made. Section 235 was reactivated in a modified form as a result of court action, and conventional public housing through congressional direction, but not to the levels previously reached.

DESCRIPTION OF THE PROGRAM

Section 8 in general provides assistance to renters whose incomes are 80 percent or less of the median in their area. For operational purposes, the limit for four-person families is set at 80 percent of median, and adjustments are made up and down for larger and smaller households. Thirty percent of those assisted must have incomes below 50 percent of median, similarly adjusted for household size. The assisted household pays 15 to 25 percent of its gross income for rent, the exact percentage varying with its size. The Government pays the landlord the difference between the household's payment and the contract rent approved by HUD. The only Federal criterion for tenant participation is income. Localities may set other requirements or establish priorities in types of households assisted in the rental of existing units.

The apartments which tenants rent may be existing units, or units to be rehabilitated or in proposed new construction. To rent an existing unit, a family must first receive a certificate from a public housing agency (PHA) and then locate and rent a unit which meets quality standards at an acceptable rental from a landlord who agrees to participate in the program. Households may continue to live in apart-

¹ Of the U.S. Housing Act of 1937, as amended by the Housing and Urban Development Act of 1965.

² Of the National Housing Act of 1934, as amended by the Housing and Urban Development Act of 1968.

ments they already occupy if they meet requirements. For rehabilitation and new construction, the developer obtains a prior commitment from HUD to subsidize some or all of the units in the completed building. The owner then rents to any applicant household, as in any rental in the private market, provided its income is below the maximum. There are some existing units in FHA-insured, financially troubled structures in which section 8 has been attached to the project, as with new construction.

The rents in all types of programs must be no higher than fair market rents (FMR) established by HUD for each housing market area in the country, with the possibility of exception up to 20 percent higher with HUD approval. Fair market rents are set separately for each of the program types, for the kind of building in which the unit is located (for example, walk-up, elevator), and by number of bedrooms. In addition, contract rents must be approved individually for each unit, based on rents for comparable apartments in the area.

The number of assisted households nationally is determined by the size of the authorization and appropriation of contract and budget authority by the Congress. The central HUD office allocates this amount among its regional offices, which in turn allocate funds among field offices in their jurisdictions. The field offices distribute the funds among the program types, and then receive proposals from public housing agencies for participation in the existing program and from developers for the new construction and rehabilitation programs. Allocations are made on the basis of population and other criteria established in the Housing and Community Development Act of 1974, including conformity with a housing assistance plan prepared in localities in accordance with the terms of that act. There are some special restrictions and incentives in the allocations; 20 to 25 percent of the funds must be used in nonmetropolitan areas, and HUD has an arrangement with the Farmers Home Administration to use section 8 subsidies in conjunction with units it assists in its section 515 program. Similarly, projects for the elderly with section 202 loans also receive section 8 assistance, currently, by HUD regulation, for all their units. Special bonuses can be given to metropolitan areas whose separate municipalities have entered into cooperative agreements so that families may rent throughout the area; and to cities in which building trade unions have set special rates to encourage rehabilitation. Special allocations may be made to State housing finance and development agencies (HFDA) for projects which they finance.

For new construction, there are requirements to be met other than rent levels. These include site location criteria, environmental impact considerations. HUD minimum property standards, and payment of prevailing wage rates. If FHA insurance is desired, FHA underwriting procedures must be followed and standards met. The procedure with private financing is complex and time-consuming. Special "fast-track" processing has been established for HFDA-financed projects which expedites their development.

The following sections report on the appropriations for the program the level of activity achieved, the types of households assisted, and the problems encountered in its administration and use. These are followed by an Appendix which contains a much more detailed description of various aspects of the operation of the program.

AUTHORIZATION AND APPROPRIATION OF FUNDS

On September 19, 1973, the President announced resumption of the low-rent public housing section 23 leasing program under revised regulations, and this was followed by the adoption of a renumbered section 8 in the 1974 act. Its expected dimensions can be seen in the HUD budget proposals for fiscal 1976, which estimated that annual contribution contracts would be reserved for 200,000 units in fiscal 1975 and 400,000 in fiscal 1976. The act authorized additional annual contributions contracts of \$1.225 billion, the bulk of which was available for section 8. At least \$150 million per year was to be used for units owned by public housing agencies, of which not more than half were to be constructed or rehabilitated for ownership under section 8. In addition to this \$150 million per year, \$15 million in each of fiscal 1974 and 1975 was authorized to finance low-cost housing for Indians, none of which could be used under section 8. Operating subsidies and other management costs also fell under this authorization. HUD, in January 1975, allocated \$900 million to section 8 use.

The 1976 Housing Authorization Act added \$850 million in contract authority for fiscal year 1977, with \$633 million for section 8. The HUD fiscal year 1977 appropriation law—P.L. 94-378—released \$520 million in contract authority for section 8, out of a total contract authority appropriation of \$675 million. Using this appropriation and authority carried over from earlier years, on December 8, 1976, HUD allocated \$564 million to regional offices for use in section 8 activities.

ACTIVITY UNDER THE PROGRAM

Reservations

From the beginning of the program through September 30, 1976, reservations totaled 585,000 units (exclusive of some 7,000 which lapsed and were returned). One-third were for new construction, one-twentieth for rehabilitation, over two-fifths for units in the existing unit program, and just short of one-fifth for loan management and property disposition units (Table 1). Reservations are made at the time of preliminary acceptance of a proposal in the new construction and rehabilitation program, and at the time of acceptance of a PHA proposal in the existing program.

TABLE 1.—ACTIVITY UNDER SEC. 8, BY PROGRAM TYPE, FISCAL YEAR 1975 THROUGH TRANSITION QUARTER AND ESTIMATED FISCAL YEAR 1977-78

[Thousands of units]

Program type	Actual						Estimate	
	Total actual		Fiscal year 1975	Fiscal year 1976	Transition quarter (July 1 to Sept. 31, 1976)	Fiscal year 1977	Fiscal year 1978	
	Units	Percent						
A. Reservations:								
New construction ¹	189.4	33	32.4	91.1	66.0	91.1	199.0	
Rehabilitation.....	23.4	4	4.4	10.1	8.8	25.5	23.0	
Existing.....	258.4	44	55.3	127.9	75.2	72.6	117.0	
Loan management and property disposition.....	111.5	19		43.9	67.6	NA	55.0	
Total.....	582.7	100	92.1	273.0	217.6	189.1	394.0	
B. Starts:								
New construction.....	32.3	94		13.0	19.2	100.0	100.0	
Sec. 202 ²						(28.1)	(31.1)	
Rehabilitation.....	2.1	6		1.2	.8	10.0	25.0	
Existing.....	NA		NA	NA	NA		NA	
Loan management and property disposition.....	NA		NA	NA	NA	NA	NA	
Total.....	34.3	100		14.3	20.0	110.0	125.0	
C. Completions:³								
New construction.....	6.3	7		13.4	12.9	20.0	50.0	
Sec. 202 ²							(15.6)	
Rehabilitation.....	.5	1		.3	.2	5.0	10.0	
Existing.....	54.3	59		29.5	24.7	94.5	170.0	
Loan management and property disposition.....	30.9	33	NA	2.5	28.4	80.5	5.0	
Total.....	92.0	100		35.7	56.3	200.0	235.0	

¹ Including conversions into sec. 8 of structures begun under other programs.² Structures financed under sec. 202 with sec. 8 commitments are included in new construction.³ Includes existing units available for occupancy

Note: Details may not add to totals because of rounding.

Source: Summary of HUD budget, fiscal years 1976, 1977, and 1978.

The time which will elapse before actual occupancy is problematic. The program was slow in getting under way. A lengthy period followed its adoption, during which HUD prepared and issued income limits, fair market rents, regulations, and handbooks, and allocated funds to the regional offices. The regional offices in turn allocated funds among the field offices, who then followed complex prescribed procedures in allocating funds among localities and program types and obtaining proposals for reservations. The first reservations were not made until the spring of 1975, and occupancy of existing units did not begin until November of that year.

Reservations consistently fell short of targeted goals until the transition quarter (Table 2). They were far ahead in the transition quarter, however, and during the entire 15-month period of July 1, 1975-Sept. 30, 1976, 490,000 units were reserved instead of an expected 400,000. The pace dropped again during the first quarter of fiscal year 1977, with only 3,700 units reserved in the four months from October 1, 1976 to January 31, 1977, exclusive of special programs such as elderly housing (section 202) receiving section 8 assistance.

TABLE 2.—COMPARISON OF UNITS EXPECTED IN 1976, 1977 AND 1978 BUDGETS AND ACTUAL PERFORMANCE

	Activity year			
	1976	Transition quarter	1977	1978
A. RESERVATIONS				
New construction:				
1976 budget	300,000			
1977 budget	90,000	22,500	112,500	
1978 budget	¹ 91,130	¹ 65,986	91,065	199,000
Rehabilitation:				
1976 budget				
1977 budget	10,000	2,500	12,500	
1978 budget	¹ 10,123	¹ 8,848	25,455	23,000
Existing:				
1976 budget	100,000			
1977 budget	132,000	33,000	165,000	
1978 budget	¹ 127,889	¹ 75,157	72,555	117,000
Loan management:				
1976 budget				
1977 budget	88,000	22,000	110,000	
1978 budget	¹ 43,884	¹ 67,564		55,000
Total:				
1976 budget	400,000			
1977 budget	320,000	80,000	400,000	
1978 budget	¹ 273,026	¹ 217,555	189,075	394,000
B. STARTS				
New construction:				
1976 budget	140,000			
1977 budget	39,600	22,500	110,700	
1978 budget	¹ 13,039	¹ 19,245	100,000	100,000
Rehabilitation:				
1976 budget				
1977 budget	4,400	2,500	12,300	
1978 budget	¹ 1,248	¹ 803	10,000	25,000
Existing:	(²)	(²)	(²)	(²)
Loan management:	(²)	(²)	(²)	(²)
Total:				
1976 budget	140,000			
1977 budget	44,000	25,000	123,000	
1978 budget	¹ 14,287	¹ 20,048	110,000	125,000
C. COMPLETIONS				
New construction:				
1976 budget	27,000			
1977 budget			3,600	
1978 budget	¹ 3,407	¹ 2,941	20,000	50,000
Rehabilitation:				
1976 budget				
1977 budget			400	
1978 budget	¹ 250	¹ 218	5,000	10,000
Existing:				
1976 budget	70,000			
1977 budget	47,000	40,000	173,000	
1978 budget	¹ 29,531	¹ 24,746	94,500	170,000
Loan management:				
1976 budget				
1977 budget			35,000	
1978 budget	¹ 2,480	¹ 28,442	80,500	5,000
Total:				
1976 budget	97,000			
1977 budget	47,000	40,000	212,000	
1978 budget	¹ 35,668	¹ 56,347	200,000	235,000

¹ Actual number achieved.² Not applicable.

Source: Summary of HUD budget, fiscal year 1976, 1977, and 1978.

Reflecting budget and contract authority limitations and directions in the 1976 Housing Authorization and Appropriation Acts, the 1978 budget estimate, appearing in January 1977, lowered expected reservations for fiscal year 1978 from a projected 400,000 in the 1977 budget to 189,000. Although the number of projected new construction units was cut from 112,500 to 91,000, this represented an increase in proportion from 28 to 48 percent. The revised budget, issued in February 1977, increased the total of subsidized units from 235,800 to 400,000.

The 235,800 figure includes 46,700 conventional public housing units. It is not clear from the published budget revision whether all the 164,000 additional units are to receive section 8 assistance or whether some are to be added to public housing. As of this writing, the future of all the subsidy programs, including section 8, are under review by the congressional committees.

During the initial year of the program, reservations for new construction were limited to conversions from other programs and projects financed by State Housing Finance Agencies (Table 3). The State agencies were responsible for 94 percent of all reservations in fiscal year 1975. Faced with difficulties in selling bonds, the State agencies in following years managed to increase reservations in absolute terms but their share dropped to slightly over a quarter of reservations made in fiscal year 1976 and the transition quarter.

TABLE 3.—SOURCE OF ACTIVITY FOR RESERVATIONS BY TYPE OF SEC. 8 PROGRAM, BY YEAR

[Units in thousands]

Source of activity	Total		1975		1976 and TQ	
	Number	Percent	Number	Percent	Number	Percent
A. NEW CONSTRUCTION						
Conversions.....	8.3	4	1.9	6	6.4	4
HFDA ¹	71.1	38	30.3	94	40.8	26
Sec. 202.....	7.8	4			7.8	5
Loan management—						
Property disposition.....						
Other.....	102.2	54	.1	(*)	102.2	65
Total.....	189.4	100	32.4	100	157.1	100
B. REHABILITATION						
Conversions.....	.3	1	.1	2	.2	1
HFDA ¹	7.6	33	4.1	93	3.5	19
Sec. 202.....						
Loan management—						
Property disposition.....	1.9	8			1.9	10
Other.....	13.5	58	.2	5	13.3	79
Total.....	23.4	100	4.4	100	19.0	100
C. EXISTING UNITS						
Conversions.....	17.1	5	1.2	2	15.9	5
HFDA ¹	23.8	6	5.1	9	18.7	6
Sec. 202.....						
Loan management—						
Property disposition.....	111.7	30			111.7	36
Other.....	217.3	59	49.1	89	168.2	53
Total.....	369.9	100	55.3	100	314.5	100
D. TOTAL OF ALL TYPES						
Conversions.....	25.7	4	3.2	3	22.5	5
HFDA ¹	102.6	18	39.5	43	63.0	13
Sec. 202.....	7.8	1			7.8	2
Loan management—						
Property disposition.....	113.6	20			113.6	23
Other.....	333.0	57	49.4	54	283.7	57
Total.....	528.7	100	92.1	100	490.6	100

¹ Housing Finance and Development Agencies.² Less than 0.5 percent.

Source: HUD unpublished tables.

Over the period of the program's activities through September 30, 1976, somewhat over half of the new construction reservations were

received by private developers and three-eighths by State Housing Finance Agencies. It is estimated that three-quarters of actual starts were financed by State agencies, reflecting the difficulties developers seeking other types of financing have experienced in trying to operate under the program. For existing units, the loan management/property disposition program took second place to private landlords. Not in existence in 1975, it received over a third, 36 percent, of reservations for existing units in fiscal year 1976 and transition quarter.

Activity was not evenly divided among the HUD regions (Table 4). This was partially because of differences in allocations arising out of the distribution formula and procedures, and partially from the activities of the HUD field offices, developers, and public housing agencies in the regions. One-fifth of all reservations were made within the Chicago region, and Atlanta and New York received 16 and 15 percent respectively. At the other extreme, only 3 percent were made within the Seattle region, a small region in terms of population. There was also a difference among the regions in types of programs, ranging from just under half the units in existing housing in Chicago to seven-eighths in the Dallas region. The distribution among program types reflected not only field office judgments and housing market conditions within each region but also the degree of conversion from other programs, the activity of the State housing finance agencies, and the use made of the loan management program.

TABLE 4.—RESERVATIONS BY REGIONS, BY PROGRAM TYPE, CUMULATIVE THROUGH SEPT. 30, 1976

[Units in thousands]

Region	Total		New construction		Substantial rehabilitation		Existing	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
I.—Boston.....	43	7	12	6	3	13	28	7
II.—New York.....	87	15	34	18	7	30	46	13
III.—Philadelphia.....	51	9	20	11	2	9	29	8
IV.—Atlanta.....	91	16	25	13	3	13	63	17
V.—Chicago.....	119	20	57	30	5	22	57	16
VI.—Dallas.....	55	9	6	3	1	4	48	13
VII.—Kansas City.....	28	5	11	6	1	4	16	4
VIII.—Denver.....	16	3	8	4	—	—	8	2
IX.—San Francisco.....	74	13	11	6	1	4	62	17
X.—Seattle.....	18	3	5	3	—	—	13	3
Total.....	583	100	189	100	23	100	370	100

Note.—Details may not add to totals because of rounding.

Source: HUD unpublished tables.

Starts

Starts have lagged even more than reservations behind original goals, but also showed some speeding up in the transition quarter. There were no new construction starts in fiscal year 1975, 13,000 in fiscal year 1976, and 19,000 in the transition quarter. Of a projected 7,000 rehabilitation starts in the 15-month period, 2,000 materialized.

Completions and occupancy

Completions in a new construction or rehabilitation program of course can be expected to be 1 to 2 years behind starts. As of the end of September 1976, only 7,000 new or rehabilitated units were com-

pleted, almost all, if not all, conversions to section 8 from starts made under section 23 or section 236. However, there have been delays in bringing existing units into occupancy as well. Of the 369,000 existing and loan management units for which funds were reserved, only 85,000 reached occupancy by the end of the transition quarter. Again, however, the process seems to be speeding up; $1\frac{1}{2}$ times as many existing and loan management units were occupied in the 3 months of the transition quarter as were occupied in the entire 1976 fiscal year. No data are available for fiscal year 1977.

ASSISTED HOUSEHOLDS

Households to be assisted are those whose incomes are 80 percent or less of the median income in the area in which they live, with adjustments up or down for number of persons in the household. Adjustments can also be made in places with very low median incomes or very high housing costs. This is roughly equivalent to the regular income limits for the old section 236 program, and, in general, lower than the section 236 exception limits, which assisted some less needy families and thereby encouraged a greater degree of economic mixing within a project. There is a further requirement that at least 30 percent of assisted households at initial occupancy must be of very low incomes, that is, with incomes of not more than 50 percent of median, and that this proportion be kept to the degree possible on re-renting. By regulation, except for projects financed by a State housing finance agency, this requirement must be met by each newly constructed or rehabilitated project, rather than over the program as a whole.

Median incomes of course vary tremendously among different localities and change over time. Adjustments in income limits are made on a nationwide basis each year, as well as in individual communities during a year at the request of the local public housing agency or on the initiative of the HUD field office. Currently, the maximum income limit for four-person households ranges from \$14,500 in such high-cost metropolitan centers as New York and Washington, D.C., to a low of approximately \$4,000 in low-income rural counties. For most places this maximum falls between \$8,000 and \$12,000. Under HUD regulations, four-person households are generally limited to the 80 percent of median income established in the law; one-person households are limited to 50 percent of median, while limits for eight or more persons go up to the median. Similarly, limits for very low income households range from 30 to 66 percent of median, according to size.

These limits are, of course, just that, maximum limits. In fact, the indications are that at least in the existing program, primarily families with very low incomes are being served. HUD has initiated a nationwide study of the operation of the program, from which more reliable knowledge will be obtained of families being helped. Currently, only a somewhat impressionistic survey is available of the occupants of existing units, conducted in the spring of 1976.³ It in-

³ "Section 8 Housing Assistance Payments Program. Existing Housing." Field study, Office of Program Analysis and Evaluation, HUD, August 1976.

icated that the average income of households in the existing program was approximately \$3,800, averaging about one-third of the median income; almost seven-eighths of the households had very low incomes. This disproportionate number of very low income households may result from the fact that most public housing agencies are public housing authorities, whose clients in the past have come from such households and who may experience difficulty in reaching those with somewhat higher income.

A further reason for these low incomes, however, is the high proportion of elderly and handicapped, who generally have lower incomes than other families. This same study showed 34 percent of the assisted households were elderly and another 14 percent were handicapped or disabled. A report by GAO states that 57 percent of tenants in California as of February 1976, were elderly.⁴ HUD reports that of reservations made through the end of calendar 1976, almost half were for units for the elderly and handicapped, comprising about a third of the units in the existing program and about two-thirds of the new construction.⁵

With this large proportion of elderly, it is not surprising that the survey found that three-fifths of the participant households consisted of one or two persons. In general, large households have had difficulty in making use of the program. This seems to result partly from low fair-market rents, particularly for large units; from landlord reluctance to rent to large families which generally are regarded as making rental properties more difficult to manage; and from shortage of large apartments in the rental stock. This difficulty in assisting large households was one of the reasons HUD permitted local public housing agencies to accept rents for some units above the published FMR. In addition, HUD is now considering setting separate rents for single-family houses, which are more suitable for larger families but usually have higher rents than apartment accommodations.

PROBLEMS AND PROSPECTS

Comparison of program types

Despite their inclusion in the same section of the Act, existing housing, new construction, and substantial rehabilitation are in fact distinct programs. Almost the only important substantive attribute held in common among these types are the income limits, which are the same for all three. Fair market rents are set separately and wide apart, the function of the public housing agencies are quite different, separate regulations have been issued, and their prospects and problems are of a quite different nature. Moreover, state housing finance and development agencies (HFDA's), which hold permanent financing of new and rehabilitated residential structures and are increasingly participating as public housing agencies in the existing program, work under their own set of streamlined regulations. Consequently, they experience difficulties unlike those in privately financed development.

Not only are the program types distinct in operation, but they are also viewed as serving different functions, which to some degree

⁴ "Major Changes Are Needed in the New Leased-Housing Program," General Accounting Office, Jan. 28, 1977, p. 42.

⁵ HUD unpublished tables.

are contradictory, and they are in competition for funds. All have the primary purpose, of course, of providing housing to low-income households. The new construction program, however, is also regarded as a way of stimulating the construction industry during a period when multifamily construction is at a low level. Rehabilitation and the existing programs, for their part, are seen as ways of preserving or renewing the existing housing stock and protecting the vitality of existing neighborhoods and cities. Use of existing structures has also been urged as a means of enlarging freedom of choice in housing for lower-income families, who thereby are not constrained to particular subsidized units. There are those who expect all types to serve as a means of providing opportunity to low-income and minority households to move from areas in which they are now concentrated, so as to promote the goals of economic and racial mix throughout the Nation's neighborhoods. There is no attempt to reconcile the conflicts which might arise between the promotion of mobility and the effort to preserve existing neighborhoods.

Cost.—Congress controls the level of activity in the program not only through appropriations for annual contract authority but also through setting limits on budget authority (that is, the total expenditure over the life of contracts by which the Government is bound). Direct subsidy costs vary both within each program type among market areas because of differences in incomes, construction costs, and approved rents, and also among program types, which have different average costs in meeting their varying social goals. New construction, particularly, is expensive not only because of actual building costs but also because of added time and monetary costs occasioned by meeting the social purposes embodied in environmental protection, metropolitan goals expressed in the so-called A-95 review, equal opportunities, payment of prevailing wages, and so on.

There are not yet sufficient data on actual costs for any program type because of the low level of activity, and estimates vary according to the assumptions made. A CRS study has estimated the first-year direct subsidy for an FHA-financed new construction unit housing a tenant with a \$4,000 income at \$3,343, and a State-financed unit at \$2,808.⁶ With indirect subsidies in the form of administrative costs and taxes foregone, the total went to \$3,643 and \$4,015 respectively. HUD's comparable estimates were \$3,504 and \$3,010 for direct costs and \$3,791 and \$4,247 including indirect costs.⁷ HUD also estimated the subsidy for housing such a family in an existing unit at \$1,519. The GAO, with somewhat different assumptions and for a family with a \$4,250 income living in a unit newly constructed by a limited dividend company, estimated the average annual discounted direct subsidy over 20 years at \$1,816, and the total, including indirect costs, at \$2,149.⁸ Estimates for a "very low income" tenant in existing housing, based on established fair market rents in several places, ranged from \$772 to \$1,273 per year, averaged over a 5-year period.

⁶ R. Edelstein J. Guttentag "Interest Rate Change Insurance and Related Proposals . . . Several Federally Assisted Programs," Apr. 20, 1976.

⁷ Testimony by Carla Hills at hearing before the U.S. Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 2d sess., June 23, 1976, pp. 36, 37.

⁸ "A Comparative Analysis of Subsidized Housing Costs," Program Analysis Division, General Accounting Office, July 28, 1976, pp. 20, 32.

Whatever the actual costs will turn out to be, it seems clear that the program using existing housing is least costly both in immediate expenditures and in budget authority, since the contract is for a maximum of 15 years. This partially explains HUD's desire to concentrate on this type. Criticism has been raised that the relatively low cost in contract authority is produced to some extent by the low fair market rents (FMR), at the price of discouraging many landlords from entering the program, keeping them from bringing units up to HUD quality standards, and limiting tenant movement from low-rent poverty areas to others where a racial or economic mixture could be achieved. Moreover, the short durations of the tenant lease and HUD contract, which promoted low impact on budget authority, are seen also to discourage substantial investment in improvements on the part of private landlords.

In new construction, the assistance contract is attached to particular units and extends for 20 years for privately financed construction and 40 for that financed by an HFDA. The contract authority for each is approximately the same, but developments that are privately financed require less budget authority. The State agencies and some others believe this is a spurious advantage. Since rents are not high enough to permit amortization of the mortgage in 20 years, debt service will continue when subsidy payments end, according to current law. There is little likelihood that tenants then in residence will be able to pay the rent increases required to meet the increased charges. This low probability arises, first, from the requirement that at least 30 percent of tenants be of very low income, not only on initial renting but, to the degree possible, in rerenting; and second, it can be expected that there will be greater propensity to move by households whose incomes rise than by those whose incomes remain steady or fall, since the higher the income the greater the housing opportunities and the chance of reducing rent payments below 25 percent of income. Under these circumstances, it appears highly probable to some observers that Congress will take action to extend the subsidy to prevent massive evictions. They see HFDA's to be currently disadvantaged, but no ultimate saving in the use of Federal funds.

Location of projects.—Others see the limiting of the subsidy to 20 years as a way of forcing more careful location of projects in areas where there is likely to be a demand for unsubsidized units. This would both promote an economic mix of tenants while the subsidy is in force, and facilitate the ultimate shift to totally unsubsidized occupancy.

There is some impression that projects are being located in areas with greater market demand than was the case with section 236 projects. This is not reflected in subsidy requests under section 8. Private developers almost always ask for subsidy of all units regardless of their expectations in this respect. While HUD initially sought ways of encouraging economic mix, the program rules in fact discourage this. Developers apply for 100 percent subsidies since, under HUD procedures, they cannot obtain an increase in the number of subsidized units once they have contracted for partial coverage; and they are penalized for requesting total coverage only if a competing developer obtains a priority in consideration of his proposal by

requesting 20 percent or fewer units, an unlikely occurrence. The State HFDA's, which have their own goals with respect to economic mix, have more often requested partial subsidization.

Competition for funds.—There is an obvious competition in the division of contract and budget authority among program types, such as existing and new construction, and between private financing and HFDA set-asides in new construction. The set-asides for special programs, notably section 202 housing for the elderly, have also affected other types. Section 202 reservations are made from field office allocations, and HUD's central office has instructed the field offices to reserve funds for total coverage of section 202 projects with preliminary approval, even though section 202 processing takes considerable time, and indeed, even though all the regulations for such processing are not yet even complete. Some field offices seem to have insufficient allocation to cover all the section 202 units in their area, hence no other funds left for other new construction, whether privately financed or HFDA set aside. The Housing and Development Reporter⁹ notes that HUD's reaction to this situation has been to attempt to recapture reservations from projects which have not progressed rapidly enough from preliminary approval to final acceptance, regardless of whether the delay has been occasioned by slowness on the part of the developer or of HUD offices.

Existing programs

Rent levels.—The level of the FMR set by HUD is crucial to the workability of the existing programs. The FMR's originally set were criticized sharply, and revised rents were issued in some places. The GAO reports a general belief that landlords are entering the program only in areas where there are vacancy problems.¹⁰ It was in response to such criticism that HUD granted PHA's the right to permit rents above the FMR's for 20 percent of its units.

Management.—A related problem for the owner is the provision of adequate management to an income group with which he may have had little experience, irrespective of rent received. Low-income families, in general, have in the past seemed to require a number of services and amenities which private landlords are not normally equipped to provide and which serve to raise the rents necessary for successful operation and maintenance above rents for physically comparable units in the unsubsidized market. These needs may range from extra janitorial services through budget counseling and provision of space for day care centers.

Less experienced owners may be more successful in accomplishing their management functions by exercising the permission to contract with another private or public entity for management services. The value of this permission to contract for management services is limited, however, by a prohibition against having a development managed by the same agency that administers the subsidy. In many places, this administrative agency will be the public housing authority, and it is the same authority which is likely to have the most experience in managing standard quality structures occupied by low-income

⁹ The Housing and Development Reporter, Jan. 24, 1977, vol. 4, p. 733.

¹⁰ "Major Changes . . ." GAO report, op. cit., p. 19.

tenants. In some areas, it may indeed be the only entity with such experience. In its last revision of the regulations, HUD made it clear that the administration of the contract could be transferred to another PHA or to HUD itself, thus permitting the housing agency to manage the project.

Housing quality.—Fears have been expressed by housing specialists that quality will suffer because of tenants' lack of experience in renting, management problems, and inadequate inspections. In part, this fear is based upon the experience with the quality of units found by welfare recipients in States where they receive rent payments independent of other allowances, a system similar to, though not identical with, the section 8 program. One study of welfare tenants indicated that 54 percent of such families occupied substandard or overcrowded housing.¹¹ There are no data currently available on which to base a judgment of the actual results in the section 8 program. The HUD-commissioned study already referred to will examine this question.

Adequacy of PHA administrative allowance.—An additional group of questions relate to the adequacy of the administrative allowance for the public housing agency. Agencies are allowed \$275 per unit for initial startup costs, and a continuing administrative allowance for each unit equal to 8½ percent of the area's FMR for a two-bedroom, non-elevator apartment. These fees are deducted from the amount reserved under the annual contributions contract, which can be no higher than the total approved rent of the units. The actual housing assistance payments contract is based on public housing agency estimates of the total rents minus estimated rent to be received from tenants. The amount of the estimated rent from tenants minus administrative fees and startup costs is placed in a reserve fund to be drawn upon as needed. Difficulties can arise in several ways. First, if the number of units allocated to the PHA is too small, the fee may be inadequate to cover overhead costs in operating the program. The GAO reports that estimates of the minimum necessary to make operation economically feasible range from 50 to 100 units; in fact, many communities have received smaller allocations.¹² This problem is one reason for the increased activity of HFDA's in the existing program, since they can act as PHA on behalf of several smaller housing authorities.

Second, the estimates of total rents and expected tenant incomes are made prior to certification of tenants and approval of leases. Agencies are expected to maintain controls so that the actual unit sizes do not vary significantly from those estimated, and can do this by establishing priorities in certification of households. Tenant incomes are more difficult to control. If they are lower than expected, the housing allowance estimate will be for an insufficient amount. The owner must be paid, so the difference must come from the PHA administrative payment until authorization is received to take it from the reserve account. Request for this authorization must travel through the field to regional office and then on to central HUD, where there is frequently a delay of months. Moreover, if the tenants' pay-

¹¹ Testimony by Bernard J. Frieden, reported in Papers submitted to Subcommittee on Housing Panels, House Committee on Banking and Currency, June 1971, p. 481.

¹² Op. cit., p. 40.

ments are sufficiently low, there will not be enough money to pay the PHA administrative costs. As happened in the public housing program, the PHA can deal with this only by attempting to attract more of the higher-income strata within the maximum income limits. If successful, this shifts some of the benefits from the lowest income group to a somewhat higher one. In a new construction project in which all units are subsidized, this shift would serve to promote economic mixing, but in the existing program tenants find their own units and a landlord may have both section 8 and nonsubsidized tenants, so the building may already be economically integrated.

Dispersion vs. renewal of neighborhoods.—There is some doubt as to the efficacy of the program in encouraging the dispersion of assisted families rather than their concentration in low-rent neighborhoods, especially in view of low FMR's in some areas and the rent-reduction incentive. In order to strengthen the general principle of promoting dispersion, the regulations were amended to state that "neither in the provision of assistance * * * nor by any other action shall the PHA directly or indirectly reduce the family's opportunity to choose among the available units in the housing market." Indeed, the positive injunction is laid upon the PHA to "promote greater choice * * * by seeking participation of owners in any area in which the PHA is not legally barred from entering into contracts," advising families of their right to lease in such areas, and developing cooperative arrangements with other PHA's. HUD states, moreover, that it will give preference to PHA's which provide the broadest geographical choice. The HUD bonus for metropolitan housing opportunity plans, described in the section of this report dealing with operation of the program, was also adopted to promote this objective. The proposed concentration of substantial rehabilitation assistance in a Neighborhood Renewal Strategy Area, also described later, would seem to be contrary to this purpose. It might, however, serve to strengthen the livability of a particular neighborhood, if care is taken to prevent the number of assisted households resident in rehabilitated units from becoming so great a proportion of the locality's families that an impacted low-income neighborhood is created.

Impact on general rent levels.—Another question, which can be resolved only by experience, is the impact of the added demand made possible by the program upon the general rent level in the area. This will depend first of all upon the number of units assisted, since it will have an effect only if it reaches a substantial level in any one housing market area. Even with a large demand, the impact will vary among communities depending upon the number of vacancies in standard quality units of the appropriate rent levels. The degree to which the supply of low-income housing is increased by including rehabilitation or new construction in the program will also affect the results. Judging from national data on rental vacancies, one can expect that rentals of larger units, which are in short supply in many places, will go up faster than those of smaller units.

NEW CONSTRUCTION

The major deterrent to the new construction program has, from the start, been financing. In conventional financing, there is a ques-

tion of duration of the subsidy, the rent level, and payment for vacant units. In FHA-insured projects, there is the difference between FHA-approved and section 8 determined "reasonable" rents. For State financing, there is the question of the ability of the States to sell bonds, with or without possible HUD guarantees and subsidies for taxable bonds, complicated by the difficulty in obtaining allocations from area offices in the absence of definite set-asides.

Rent levels.—When fair market rents for new construction and rehabilitation were first announced, there was considerable comment that they were too low to make development feasible. In practice, the requirement that the contract rent be "reasonable" seems to have been more difficult for developers to meet. The FMR's have been raised over time, and as noted previously, are subject to increase or exception by action of the HUD area or regional offices. The "reasonable" rent is estimated individually for each project during the review process, and is based on the judgment of an appraiser who is specifically enjoined from considering the relevant FMR in making his estimate. For new construction, it is based on comparison with three to five recently constructed nonsubsidized projects of modest design and with apartments of comparable size located in the same community. If there are no recently constructed developments, older units may be used with appropriate adjustment; if there are none in the same community, the nearest community in which there are such developments may be used. There is considerable difference in practice among appraisers and among field offices in the liberality with which comparability is defined and adjustments made. Moreover, comparable unsubsidized units in the same market, even if built at the same time, do not necessarily have the same costs due to differences in environmental requirements, meeting Davis-Bacon prevailing wage rates, minimum property standards, and extra management requirements inherent in participating in the subsidized program.

HUD has justified the use of comparable rents, rather than construction costs, as the basis for establishing contract rents for a new project on the theory that in an area in which there is a short supply of apartments, and hence a need for new construction, rents will be driven up sufficiently in comparable units to support new construction. On the other hand, if rents are too low, this indicates an adequate supply of existing units so that new construction should not be undertaken. This theory may indeed be true over the long run and in a general sense throughout a housing market area. It is less certain in situations involving low-income households and periods of 2 or 3 years. Many housing experts hold that an adequate number of units or even oversupply for middle-income households need not indicate sufficient units of standard quality for those of low income, and a shortage of units at low rents need not raise rents sufficiently to support new construction. Even if it does, new construction is unlikely to release much housing to low income tenants, and low-income households would be sadly pressed before new units could be ready for occupancy.

In those places where approved rents have been too low to support new construction, developers have understandably been reluctant to build. Even if they were prepared to gamble that rents would be in-

creased or costs somehow reduced below their estimates, lending institutions have not been willing to take the risk. The situation has been eased somewhat for projects with FHA insurance by the release of funds for GNMA to purchase FHA-insured multifamily mortgages at 7½ percent interest, thereby lowering debt service costs for proposed projects. FNMA, which acts as GNMA's agent in making commitments under this program, estimates that of the projects using the \$3.2 billion currently committed, approximately a third have also obtained a section 8 commitment.

HUD has itself made an effort to ease the problem, although not prepared to base contract rents on construction costs. Changes were first made in November 1976, to permit adjustments for elderly projects, for management in projects in which all the units were to be subsidized, and for discounts for HUD-insured mortgages or for the higher interest rates on conventional mortgages. Together, these permitted approval of contract rents which were up to 10 percent above "normal" comparability for family units and up to 15 percent greater for elderly-handicapped units. These limits were further eased just before Secretary Hills left office to permit a 10-percent increase for management costs in family projects, including those not fully subsidized, and for special design features in elderly-handicapped projects. The increase for a discount on an FHA mortgage or for a higher rate on a conventional mortgage remained at 5 percent. In addition, a 5 percent increase can be permitted by the field office for high construction costs or other unusual market conditions. Granting this additional 5 percent is conditional on the field office's full cost analysis of the proposed project and its determinations that the program for existing housing cannot be used and that there is an "overriding need" for new construction.

Section 8-FHA differences.—For FHA-insured projects, there remains a final hurdle. FHA appraisers, even when they use section 8 subsidy guarantees as substitutes for more usual marketability requirements, do not include any payments for mortgage discounts in their allowable cost estimates. Thus, a 5-percent differential remains between section 8 rents and FHA-established rents on which the supportable mortgage is based.

Although a 5-percent rent differential does not appear large, it is translated into a lower allowable mortgage and thus results in a large difference in the amount of equity investment required and an even greater increase in the cash investment above the builders' and sponsors' profit and risk allowance. The latter allowance is included in the equity investment by FHA but does not require an actual cash advance. In an illustrative example in a consultant study made for HUD, the equity increased by two-thirds and the cash advance doubled.¹³ This may or may not be a substantial stumbling block, depending upon the availability of equity investment funds, which depends upon the general economic climate, the relative degree of tax shelter offered by section 8 and alternative investments, and the degree of risk seen by potential equity investors.

¹³ "The Rent Reasonableness Test in Section 8 New Construction Program," ICF, Inc., Aug. 25, 1976 (mimeo).

Timing of approval of rents.—The regulations provide for setting the approved rents before all negotiations with HUD are completed. In a period of rapidly increasing construction costs, the developer, who has no control over the length of time which will elapse before final approval, may face greatly increased costs between his making a proposal and beginning construction. HUD has published a proposed change in regulations to permit an increase over the initial proposed rents before the signing of the agreement to enter into a housing allowance contract, in the event that there have been “unforeseeable factors . . . beyond the developer’s control” and the rent level was not a decisive factor in the proposal’s selection. Although this will be of some help, it will not resolve the entire difficulty.

After the agreement is signed, no increase is permitted. The regulations permit extension of the time estimated for completion of construction for valid reasons, but prohibit any increase in rents because of the delay, even though such delays not only add to construction cost but also may result in initial occupancy at a time when operating costs have increased above those initially estimated. The only exception is in HFDA-financed projects, where rents can be increased if interest on bonds sold to raise mortgage funds is higher than expected when rents were established. Moreover, any changes made in the plans during construction, which are subject to HUD approval, may result in lowering of contract rents, but cannot result in an increase.

It is reasonable to suppose that this requirement for prior fixing of rents leads to inflated original estimates, to the degree possible within comparability rules. It is not clear how much of a deterrent it has been to developer’s desire to participate or ability to obtain financing.

Vacancy payments.—Part of the risk seen by both mortgage lenders and equity investors lies in the provision made for payment on vacant units. For FHA-insured projects, this is limited to 80 percent of the contract rent for a maximum of 60 days, provided a good-faith effort is being made to rent the unit. For conventionally financed projects, in an effort to encourage this type of financing, HUD has extended the period for which such payments will be made to up to a year. The extension apparently covers State-financed projects as well, but as of this writing, the regulations for State agencies have not been rewritten to incorporate the change. The concern about vacant units flows from the experience with section 236, in which it sometimes took long periods to bring projects into full occupancy because of the narrow bands of eligible occupants. Under section 8, where the rent a family pays is determined solely by its income and some two-fifths of the households in an area are eligible, it would seem that such gross vacancies could arise only from building upon a totally unacceptable site or from the development’s being mismanaged to the extent that it acquires an unsavory reputation in the area. Uneasiness is still felt, however, since there are too few completed projects to judge from actual experience.

Duration of subsidy.—For privately financed projects, whether FHA-insured or conventionally mortgaged, there is another hurdle in the limitation of the subsidy to 20 years. However spurious some people may find this limitation, it is now a legal provision which produces questions in the minds of developers, mortgagees, and indeed,

FHA appraisers as to what will happen to rentability and the financial health of the project when the subsidy expires and mortgage payments continue. Congress is currently considering legislation to permit an extension of the subsidy to 30 years for conventionally financed projects, a more usual mortgage length. This extension will only be helpful if FMRs and contract rents are high enough to permit amortization in 30 years.

Adequacy of reserve.—The possible inadequacy of the reserve is a problem in obtaining financing for new construction, although not for the same reasons as in the program for existing housing. Tenants of new units, unlike those in existing units, do not receive certificates of eligibility from public housing agencies but are chosen from applicants to the units by managers or rental agents as in any rental projects in the private sector. Consequently, even with the requirement that 30 percent of occupants of each project be of very low income, the families as a whole are more likely to be at the higher range of the eligible income groups than in existing units, so the reserve fund is likely to be higher. Furthermore, there are no administrative costs to be paid from the fund. However, there are supposed to be adjustments in the contract rents and consequent housing assistance payment to the landlord at least annually, to be paid from this fund. If operating costs, and hence these adjustments, increase more rapidly than tenants' incomes and rent payments, as has been the experience in the recent past with subsidy programs in general, the reserve will be depleted long before the mortgage is liquidated. The law provides that the Secretary "shall" take "such steps as are necessary" to assure that assistance payments are increased, but if this requires amendment of existing contracts and expenditures from previously unallocated funds under HUD's control, reliance will have to be placed upon both the availability of contract authority and the speed of HUD's response to project need. In a period of rapidly rising costs, it is possible, if not probable, that a project will face default or foreclosure before remedial action is undertaken.

STATE HOUSING FINANCE AND DEVELOPMENT AGENCIES

The HFDA's fall into a class by themselves. As indicated earlier, they follow special procedures, and some think present special opportunities. They were singled out in the legislation establishing the section 8 program because of the record they had established in production of housing with section 236 assistance. As public agencies, they set their own goals for racial and economic mix and their own standards of quality and amenities, which to some degree were attained in the section 236 program. Provision of funds for them is consistent with the policy of encouraging greater State and local area activities in housing programs. At the same time, the tax-exempt status of their bonds adds a substantial indirect cost to the Federal Government, and, as explained earlier, the 40-year duration of their subsidy contract doubles the necessary budget authority over privately financed construction.

HUD is authorized to provide a set-aside of contract authorization directly to HFDA's and originally such set-asides were made. When

the State agencies found it difficult or impossible to sell their bonds in 1975-76, the set-aside from central HUD was eliminated and it has not been restored. Currently, they receive allocations only from field offices which choose to grant them. This, in effect, puts them in competition in the division of funds among program types made by each office, some of which are more sympathetic than others to the State activity.

The HFDA's do not face financing problems to the same degree or of the same type as private construction. Under the "fast track" system, they make their own certifications of reasonable rents, and tend to a sufficient liberality of interpretation to make their projects feasible. Subsidies in the projects they finance run for the duration of their mortgages. The 40-year period of amortization and their lower interest rates result in rents more likely to fall within the limits of the applicable FMRs. As mortgagees, however, they may be equally concerned about the adequacy of the reserves to meet rising costs.

The primary problem has been their ability to sell bonds with which to finance mortgages. Currently, the difficulties of the past several years have ameliorated. The tax-exempt bond market, however, began to falter even before New York's difficulties triggered a general collapse, and a slowdown is certainly again possible. There are three general programs under which they could be helped.

The first is coinsurance of their mortgages, which would make their bonds more attractive. The current HUD regulations provide for a 80-20 percent split of loss between HUD and the State agency after the first 3 percent to 10 percent of loss is taken by the State. The State agencies doubt that this split will make their bonds attractive enough to encourage purchase by large institutional investors and have suggested a 90-10 percent split. HUD does not believe that this small burden of loss will be conducive to the exercise of proper underwriting judgment in the taking of mortgages by the States. A proposal has been advanced, not accepted by either HUD or the States, that the State agencies should reinsure some part, possibly 30 percent, of any loss HUD in fact suffers, possibly by establishing a funded reserve. This would place a smaller burden of risk on both HUD and the State agency. Although regulations were issued in September 1976, no use has yet been made of coinsurance. Missouri made application in January, 1977, however, and several States are now considering similar action.

A second possible means of assistance lies in the guarantee by HUD of State bonds, which obviously would enhance their saleability. Such a guarantee is authorized by section 802(c)(1) for bonds issued to finance activities for the revitalization of slums or blighted areas, but has not been put into effect by HUD.

The third means of assistance, for which HUD has adopted regulations, is the payment of grants to cover up to one-third of the interest payable on a taxable bond. Authorized to make payments of up to \$50 million per year, without regard to the housing program for which the funds were to be used, HUD released \$15 million, with the grant limited to bonds to finance section 8 construction. According to HUD, the restriction was made partially because of a limitation on funds and partially because section 8 was already subject to HUD

standards in a way which is not true of other programs. The regulations were issued in August. Despite negotiations since then, no State has issued bonds under the regulations and proposed contract terms. No funds for this purpose were included in the fiscal year 1978 budget prepared by the Ford administration or proposed in the later revisions sent to the Congress.

CONCLUSION

It is apparent from the preceding discussion that the section 8 program is a complex system of subsidies to lower income households, usable in low-rent existing units, new construction and substantially rehabilitated units. It has proved difficult to get under way, and obstacles still remain in making use of its full potential. These relate primarily, but not solely, to the finding of units in the existing program, particularly by large households, and the financing of rehabilitation and new construction. There are also obstacles in the intricacies of regulations applicable to the individual program types. Nevertheless, there is some indication that the existing housing program is making it possible for lower-income households to find or remain in homes, presumably of standard quality, with a reduced proportion of income being paid for rent than without assistance, and at a lower cost to the Federal Government than in new construction.

Although they have had greater difficulties than the existing program in getting started, some activity has begun under the rehabilitation and new construction programs, particularly since State agencies have been able to reenter the bond market. It remains to be seen whether there are any advantages for these program types over a more direct construction subsidy, with the possibility of an operating subsidy, as in the section 236 program.

APPENDIX—OPERATION OF THE PROGRAM

DETAILED DESCRIPTION OF PROGRAM

Like earlier subsidy programs, with respect to new construction and rehabilitated units, section 8 provides a subsidy attached to units within designated structures, though the amount varies with the income to particular tenants. In the case of existing housing, it is in effect a housing allowance program whereby the subsidy is granted to the tenant who finds his own unit and who takes it with him if he wishes to move to another acceptable apartment. It is, however, outside the purview of the HUD allowance experiment. Despite its potentially greater impact, there has been no public indication that the effects of this existing unit program on the housing market will be subject to the systematic study accorded the similar experimental effort.

In 1976, a loan management and property disposition program was added, under which section 8 subsidies are being applied to FHA-insured projects in financial trouble. In theory, these projects could be of any type, but in fact, almost all reservations have been for existing units. The subsidy, however, is attached to the unit as in the new construction program.

The procedures for contracting for housing assistance payments vary among the program types. For existing housing, HUD enters into an annual contributions contract with a local housing agency, if one exists and is deemed "able and willing to implement" the program. The agency in turn enters into a housing assistance payment agreement with an owner from whom a tenant certified by the agency has chosen to rent a unit. If there is no local agency willing to conduct the program, HUD is authorized to deal directly with the owner. Thus far, it has not chosen to do so. However, in many States, a State Housing Finance Agency has assumed the agency role in rural areas or others in which local agencies are nonexistent or are unwilling to be primarily responsible. For new construction and loan management-property disposition projects, HUD enters into a housing assistance payment contract directly with the owner, who may or may not be associated with a public housing agency. Substantially rehabilitated units may be contracted for either directly, as in new construction, or through a public housing agency, as with existing units.

In all cases, the tenant rents directly from the owner, who has responsibility for rental and management. The owner then receives two separate rent payments: one from the tenant, based on his income and ability to pay, and one from HUD which covers the difference between the tenant's payment and the HUD-approved contract rent.

The tenant's rent payment is based solely upon income and family size. The basic payment is 25 percent of gross income, with a \$300 exemption from income for each minor and further exemptions for unusual medical or other expenses. A very large low-income family, that is, one with eight or more minors, or a large very low-income family, with six or more minors, or a family with "exceptional" medical or other expenses, pays 15 percent of gross income.

The contract rent is set in the housing assistance payment contract between the owner and the public housing agency or HUD. At the start of the program, it had to be "reasonable" in relation to comparable private market units. "Reasonable" was determined independently of, but could not exceed, the fair market rent (FMR) set by HUD for the area. Contract rents higher than this "reasonable" rent are now permitted, as discussed in the problems and prospects—new construction section of this report.

Fair market rents have been set by HUD separately for each of some 1,500 housing market areas, by housing type (e.g., row-house, high rise, nonelevator, elevator) and number of bedrooms. Different rents are set for each program type. FMR's are adjusted annually throughout the country, and may be changed at any time in a locality for proper cause.

Projects for the elderly can exceed published FMR's by 5 percent. For other projects, or for elderly projects above the 5-percent limit, permission to exceed FMR's must be obtained from HUD. Field offices may grant rents 10 percent above FMR's, and regional offices up to 20 percent above FMR's. For existing housing, public housing agencies are authorized to approve rents on a unit-by-unit basis of up to 10 percent above the FMR for up to 20 percent of covered units. This change was made following complaints that certified households had trouble finding units meeting section 8 quality standards within

the established FMR. Agencies may also request the HUD field office to give general approval for an increase of up to 20 percent above the FMR for all units of a particular size or type.

The section 8 program eliminates one of the major difficulties that arose in section 236 projects: the inability without further legislation to increase subsidies to compensate for sharp increases in operating costs. The law requires annual adjustment in the contract rent to reflect changes in fair market rents in the area. Further adjustments can be made for increased costs resulting from higher property taxes, utility rates "or similar costs" if their increase is not adequately covered by the change in fair market rents. Reserves are established for each project for this purpose, made up of the difference between the gross rents for which funds are reserved and the housing assistance payment made to the owner (in other words, the rents paid by the tenants). This reserve is lessened in existing housing by the payment of the agency's administrative costs from these moneys. The potential increase in subsidy amount necessary to cover the higher contract rent would be lessened, of course, by any rise in tenants' incomes, and hence in rents paid, or increased by a drop in that income.

The owner must bear the brunt of uncollected rents, whether from delinquencies or excessive difficulties in renting. The law permits assistance payments for vacant units for a maximum of 60 days for FHA-insured projects and up to a year for other projects. By regulation, this payment has been set at 80 percent of the contract rent. For existing units, it is limited to vacancies arising from broken leases.

INITIATION OF ACTIVITY

Under all program types, the initiative for activity comes from HUD. Initially, the central HUD office allocates contract authority among its field offices. The Housing and Community Development Act requires that applications for community development grants include a housing assistance plan (HAP), which assesses the housing needs of lower-income persons, including but not limited to the elderly, handicapped, large families, and those displaced by governmental action; specifies a realistic goal for their assistance; and indicates the general location in which assisted housing should be placed. In allocating housing financial assistance, HUD is instructed to consider relative needs of the communities, subject to adjustment to help them meet their housing assistance plans. Non-metropolitan areas are to receive between 20 and 25 percent of all such assistance.

Having received an allocation from the Department, each HUD field office distributes the allocation among local communities. In each place, it is further divided among existing, rehabilitated, or new construction, by size of units in each type. The office then issues a notification of fund availability (NOFA), indicating the desired program. For existing housing, it sends invitations for applications to appropriate PHA's, chief executive officers of the State, counties, and localities concerned, and to trade journals, minority press, fair housing groups, etc. The invitation sets forth the maximum number of units and geographical area. For new construction, the field office initiates the program by publishing invitations for preliminary proposals in newspapers of general circulation, and notifying the minority media,

business on its registry, community development and fair housing groups, and others. To the extent feasible, it may also notify PHA's, chief executives, etc. The invitation states the geographic area(s), the number of units, the deadline for filing proposals, and other necessary information, including the existence of a developer's packet at the field office.

In drawing up the total existing unit and new construction programs, originally the field office was instructed to consider local housing assistance plans "and any other pertinent information," but was to include rehabilitation and new construction only if it determined that "there is not and is not likely soon to be an adequate supply of existing housing which * * * can meet the needs of eligible families." Only the Secretary was authorized to establish exceptions to this preference for existing housing by designating priority areas, such as New Towns. The emphasis on existing housing met objections both in local areas, which believed HUD was ignoring what local officials considered to be a housing shortage, and from Congressmen who were concerned by a general slowdown in construction of multifamily housing during 1974-76. Consequently, the 1976 act requires HUD, to the degree practicable, to allocate funds among the types of programs in accordance with the local HAP. HUD's budget estimates for fiscal years 1977 and 1978 indicate a projected shift from existing to new and rehabilitated units.

EXISTING HOUSING

Acceptance of a proposal

The response to the issuance of an invitation for proposals in the case of existing housing comes from a public housing agency, which may be a public housing authority or any other public body authorized to develop or operate housing for low-income families. In some States, with HUD encouragement, the State HFDA has accepted responsibility for acting as the PHA in rural areas or small towns where there are no or very small public housing authorities.

The agency presents an estimate of the number and type of units which will be included in its program, as well as statements of conformity with various general requirements, such as quality standards, equal opportunity, and the like. The field office asks for comment from the local government, which it must consider in reviewing the proposal. It may approve, disapprove, or ask for modifications. If more than one agency has submitted a proposal for the same geographic area, it may divide the allotment or choose only one.

FHA activities

Once the proposed program is approved, a number of technicalities have to be resolved, but ultimately the PHA receives an annual contributions contract in an amount no greater than the total of gross rents for the unit sizes in the accepted program. Through advertisements in general and specialized press, the PHA establishes a list of applicants for certificates of eligibility and of owners who wish to rent units. Units in projects receiving housing subsidies under other programs may be leased as existing housing, provided not more than 40 percent of the households receive rent supplement, section 23, sec-

tion 236 "deep subsidy," or section 8 assistance. Families already living in public housing units or those on waiting lists for such units must apply specifically for section 8 assistance.

Renting the unit

The PHA issues certificates of eligibility to applicants whom it finds eligible, limited to the number of units for which it will have funds; a waiting list is established for remaining applicants. The family then has the responsibility of locating an apartment for itself, although the PHA is authorized to make its lists available and otherwise be of assistance. As amended effective May 16, 1976, the PHA "upon request shall provide assistance" to families having difficulty in finding an apartment because of "age, handicap, or other reasons"; it also "shall provide such assistance where the Family alleges that discrimination is preventing it from finding a suitable unit."

The family is encouraged to find a unit at the lowest possible rent by having the payment it makes reduced by the same proportion that the contract rent for the apartment it wishes to lease is below the designated Fair Market Rent. Formerly called a "shopping incentive," the name has been changed to a "rent reduction incentive," to make clear that families may remain in their current units if these meet quality standards and FMRs. In fact, HUD estimates that about two-thirds of the tenants in occupancy as of September 30, 1976, were "in place,"¹⁴ but this includes the large number of tenants in the loan management program in which the subsidy is tied to the unit. The HUD field survey, made before there were many loan management units, reported a range in the estimated proportion of in-place tenants of from 10 to 55 percent in different areas, "with more than 50 percent a not uncommon figure mentioned" by PHAs.¹⁵ It ascribes the variation to difference in market conditions, which affect the availability of alternative units, and in the age of participants, with elderly tenants less likely to move.

For tenants who remain in their units, of course, the section 8 allowance acts only to reduce expenditures for rent rather than encouraging movement, thus being in effect an income-maintenance allowance. It may, however, also serve to prevent a forced move because of a rent increase within the FMR limits but which the tenant cannot afford to pay, or to encourage a landlord, who wants to keep a desirable tenant, to make improvements to meet HUD quality standards.

The family is given a detailed description of what constitutes standard quality, and is required to rent only a unit of this quality, whether a new or in-place unit. It is hoped that this injunction, together with the family's desire for decent housing, will prevent this rent reduction credit from leading to leasing of substandard units. Also, the PHA is required to inspect the unit for acceptable quality before approving the lease and at least annually thereafter.

NEW CONSTRUCTION AND SUBSTANTIAL REHABILITATION

When the HUD field office publishes a request for a proposal for new construction or substantial rehabilitation, it must have ready

¹⁴ GAO report, op. cit., p. 42.

¹⁵ Field study, op. cit., p. 18.

a packet for potential proposers setting forth a detailed housing program which, among other things, specifies the number, type, and size of units to be built within a housing market area. The response may come from a private developer or from a PHA, either of whom can enter into a contract directly with HUD. It may also come from a private owner/PHA combination. In this case, HUD enters into an annual contributions contract with the PHA, which in turn enters into a housing assistance payments contract with the private owner, who has been approved by HUD. These proposals are for individual projects consistent with the overall program announced by HUD.

These proposals are subject to a series of reviews and exchanges between HUD and the owners before they lead to construction. The initial response is a preliminary proposal, in which the site is identified, the project generally described, and contract rents proposed. HUD submits these for both comments by metropolitan area agencies under the A-95 review process, and review by the executive of the local government in which the site is located for consistency with its housing assistance plan, if one exists, or for comment if one does not exist. If the locality claims the proposal is not consistent with its plan, HUD may rule otherwise, but must give its reasons in writing. Proposals from a State HFDA using a set-aside, which come on its own initiative rather than in response to a field office NOFA, are subject to review for consistency with the State housing plan, but need not be consistent with the local plan unless that plan itself requires consistency.

After considering all comments and ranking all proposals, the field office notifies the developer of acceptance (or rejection) of the preliminary proposal, or may ask for modifications, including lowering of the rent. The developer then submits a final proposal, with preliminary drawings and outline specifications. HUD responds again with acceptance or rejection, or a request for negotiation. If—when—HUD accepts the proposal, it requests the developer to submit an acceptance of its acceptance by a specified time. He submits this acceptance, together with his architect's certification of accord with local codes and HUD minimum property standards and a copy of working drawings and specifications. HUD then prepares the agreement for housing assistance payment or for annual contributions, according to the owner. These contracts must be executed before construction can begin. The rent accepted in the preliminary proposal stage as modified in negotiations can be increased before the signing of the agreement to enter into a housing allowance contract only up to the amount of the original proposal. HUD has published a notice in the Federal Register (December 30, 1976), to permit approval of increases above those in the preliminary proposal if the need arises from "factors beyond the developer's control," such as a change in local building codes, provided rents "were not a deciding factor in competitive selection." They would still have to meet the criteria of reasonableness and not being above the FMR. Once the contract is executed, rents cannot be increased, except as fair market rents generally are changed annually in response to changing operating costs.

If FHA insurance of the mortgage is desired, application can be made prior to, concurrently with, or subsequent to, filing the preliminary proposal for section 8 reservation. Regulations vary somewhat

depending on time of application, but in general, the project undergoes the same underwriting review and must meet the same mortgage criteria as an unassisted proposal, except that units receiving section 8 assistance are regarded as an addition to effective demand in making estimates of marketability. Estimated rent rolls for FHA insurance purposes may be lower than approved reasonable rents for section 8, resulting in a lower insurable mortgage and consequent requirement for a higher equity investment than would be necessary to meet section 8 requirements using a conventional or a State HFDA mortgage.

SPECIAL PROGRAMS

In order to use section 8 funds to promote particular social purposes, there are a number of set-asides of funds disbursed either at the discretion of HUD or through reservations at field offices outside of the regular system.

To encourage metropolitan-wide choice of housing by tenants in the existing program, HUD has established a bonus for housing opportunity plans, in which it gives increases of 10 to 50 percent, depending on the availability of funds, over amounts which would otherwise be received, in metropolitan areas in which acceptable plans for cooperative action among separate jurisdictions have been developed. To date, there are seven areas in which such metropolitan agreements have been made, and others are pending.

To encourage rehabilitation, HUD has allocated \$50 million in contract authority with which it offers bonus units for a demonstration program in cities in which unions have agreed to lower wage rates for work in the program, if other requirements have been met. Twenty-two cities are participating, with an expected renovation of 10,000 to 11,000 units.

HUD has also proposed regulations in the Federal Register of January 31, 1977, for comment by March 2, which would permit localities to concentrate activities undertaken as part of the section 8 substantial rehabilitation program in "Neighborhood Renewal Strategy Areas." Approval would be contingent upon a HUD determination that the proposed rehabilitation and associated "concentrated activities" are "likely to result in the restoration and revitalization of the area."

For rural areas, HUD has entered into a memorandum of understanding with the Farmers Home Administration, providing a set-aside of 10,000 units in fiscal year 1977, for use with the section 515 direct loan program. The FmHA will provide interest credit to sponsors who are not profit motivated to reduce the interest rate by 1 percentage point. HUD will accept FmHA certification of compliance with standards, reasonable rents, and FMR's. The reservations are made by the field office from its allocation, in consultation with the appropriate FmHA State director.

For the elderly, HUD has established a requirement for concurrent reservation of section 8 assistance on all units with section 202 loan authority. By HUD regulation, this allocation receives first priority in the field office distribution of funds.

HOUSING REHABILITATION PROGRAMS

(By Michael Agelasto, Analyst in American National Government,
Government Divisions, April 7, 1977)

HOUSING REHABILITATION PROGRAMS

This report deals with two rehabilitation programs—section 312 rehabilitation loans and section 810 urban homesteading.

Over the past several years elected officials at all levels of government have expressed a concern about the continuing deterioration of the housing stock. Local officials are now developing urban revitalization policies tailored to the specific needs of the residents of individual neighborhoods. Their policies are supported by Federal community development block grant funds and general revenue sharing moneys which, because of their "few-strings-attached" nature, can be used in ways determined at the local level. The role of the Federal Government appears to be that of providing flexible general purpose funds and certain tools, such as interest and tax subsidies, loan and grant programs et cetera.

In examining two of these "tools," this paper asks the question: do the programs address local needs and are they consistent with the primary objective which Congress has determined community development funds should address? As specified in title I of the Housing and Community Development Act of 1974, this objective is the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.¹

SECTION 312 REHABILITATION LOANS

The housing program which most directly addresses the problems of dilapidation and undermaintenance in the housing stock is that established by section 312 of the Housing Act of 1964. This provides for direct 20-year, 3 percent rehabilitation loans for residential and business properties located in urban renewal areas, codes enforcement areas, FAIR (Fair Access to Insurance Requirements) certified areas, community development block grant areas, and section 810 urban homestead areas.

Section 312 is a small program (about 4,000 loans approved annually) in relation to other HUD housing programs or when compared to other community development programs.² Residential property loans may not exceed \$12,000 per dwelling unit (\$17,400 in high cost areas). In recent years, section 312's continued authorization and

¹ Public Law 94-383, sec. 101(c).

² A comparison with other community development programs appears in Congressional Research Service, *Neighborhood Conservation Through Housing Preservation*, multilithed report 76-154G, Aug. 20, 1976, prepared by Michael Agelasto, p. 24, note 37.

appropriation have been in doubt because of the previous administration's desire to consolidate section 312 into community development block grants. In its fiscal year 1978 budget request, the present administration requested no additional appropriation for section 312, stating that a \$70 million program level would be maintained with unused available funds and loan repayments and income received during 1977.

In the first 10 years of the program, since its creation in 1964, section 312 loans were targeted to inner-city renewal areas. The 1974 Housing Act authorized section 312 loans to areas receiving community development block grant funds. A number of recent evaluations of the block grant program suggest that its focus is away from the needs of low-income and more directed to middle-income neighborhoods,³ and this suggests that section 312 funds may not be "principally for persons of low and moderate income." In addition, a 1976 General Accounting Office audit revealed that a significant portion of section 312 loans made in the Chicago and San Francisco areas were received by property owners with substantial incomes and personal assets.⁴

Last year Congress attempted to deal with the issue of ensuring that section 312 serve the lower income. The initial Senate approved version of the Housing Authorization Act of 1976 (Public Law 94-375) contained a provision creating a two-tiered interest rate structure for section 312 loans continuing the current 3-percent rate for low-income borrowers. The Conference Committee did not include this provision.

An absence of empirical data makes it difficult to evaluate the effectiveness and efficiency of the program. According to one source, the program has an 11-percent delinquency rate.⁵ The average per dwelling units loan is slightly under \$7,000.⁶ Until more data become available, section 312 may be described as incompletely evaluated.

SECTION 810 HOMESTEAD PROGRAM

Section 810 of the Housing and Community Development Act of 1974 authorizes the Secretary of HUD to transfer federally-owned properties which are suitable for a homestead program to a unit of local government or a public agency. The homes would then be transferred at a nominal cost to individuals and families, who would be obliged to make improvements with a view toward obtaining title and secure a mortgage to cover the cost of these improvements.

Appropriations are authorized to reimburse housing loan funds for properties transferred under the section and for technical assistance. Authorizations for section 810 are \$5 million for fiscal year 1975, \$6.25 million for fiscal year 1976 and the transition quarter and \$5 million

³ See, for example, Richard P. Nathan et al. "Block Grants for Community Development." First report on the Brookings Institution monitoring study of the community development block grant program. Washington, U.S. Department of Housing and Urban Development, 1977. National Association of Housing and Redevelopment Officials, 1st year report, Washington, National Association of Housing and Redevelopment Officials, 1976. Richard DeLeon and Richard LeGates, *Redistribution Effects of Special Revenue Sharing for Community Development*, Berkeley, Calif., Institute of Governmental Studies, 1976.

⁴ U.S. General Accounting Office. Letter report to Secretary of Housing and Urban Development, B-171500, Mar. 8, 1976.

⁵ U.S. Department of Housing and Urban Development. *Review of Programs and Functions*, January 1977, vol. 4, p. c-21. Transition document.

⁶ *Ibid.*

for both fiscal years 1977 and 1978.⁷ The Supplemental Housing Authorization Act of 1977, approved by the House March 10, 1977, amends section 810 of the 1974 act by increasing the authorization from \$5 million to \$15 million.

In October 1975, 23 cities were initially selected to participate in the homestead demonstration. HUD planned to contribute \$5 million in rehabilitation loans. In October 1976, HUD provided the program participants with an additional \$6.25 million in HUD acquired properties and \$8 million in rehabilitation loans, in addition to its earlier contribution of \$5 million in houses and \$5 million rehabilitation loans.⁸

Each homesteader receives a house on which the Federal Government has written off, on the average, a \$5,000 loss to the FHA insurance funds.⁹ An additional \$5,600 is pledged in local public or private funds for improving the house or upgrading services or facilities in the neighborhood of the house. Until data from HUD's \$1.5 million evaluation of the program become available, we will not know how it is working or who is benefiting. If the beneficiaries are middle-income families, one must question whether section 810 is consistent with the objectives of title I of the 1974 Housing and Community Development Act.

In theory, however, the homesteading concept has several limitations if it is to serve as part of a large scale realistic local conservation strategy. First, homesteading is a necessarily small program because it is restricted to publicly owned properties or parcels that are likely to become acquired by local governments. Second, without an accompanying subsidy for low-income families, urban homesteading does not provide a means for housing the poor. Low-income families rarely have the necessary initial capital outlay, the credit rating to obtain the mortgage, or the income to carry the loan. Finally, the program cannot serve as a mechanism for renewing deteriorating neighborhoods unless units can be concentrated, and this is often not the case.

As more information on the program becomes available, one may wish to ask (1) whether homesteading is proving a useful tool to catch incipient deterioration before it becomes a major problem, and (2) whether homesteading has a role in areas of concentrated housing abandonment.

⁷ These amounts are authorized by Public Law 93-383, Housing and Community Development Act of 1974, and Public Law 94-375, Housing Authorization Act of 1976.

⁸ HUD News, Oct. 29, 1976 (press release).

⁹ Reported in fiscal year 1978 justification materials HUD submitted to the House Appropriations Committee, p. 0-22.

HOUSING MANAGEMENT PROBLEM SURVEY

(By Francis Parente, Analyst in Housing, Economics Division,
February 15, 1977)

INTRODUCTION

Over the last several years a number of problems have arisen in connection with Federal housing programs suggesting that the programs are poorly designed, run in a lax manner, incapable of being properly administered by the Government or all of these factors combined.

Several years ago, for example, it was found that in Detroit the Department of Housing and Urban Development was acquiring a number of FHA-insured homes.¹ More recently, in 1975, it was disclosed in newspaper investigative reports that in Chicago many of these same problems persisted. In Chicago the Federal Government was found to be the owner of 3,579 vacant homes with the prospect of FHA's acquiring 5,000 to 7,000 similar homes.²

As of August 31, 1976—a year later—HUD reported a total national onhand inventory of properties and notes acquired of 303,328 units, amounting to \$4.191 billion. The unit total consisted of 250,865 multifamily units and 52,463 homes.³

Meanwhile, it was recently noted that the FHA share of residential mortgage volume in 1976 was 7 percent. In the multifamily area it was around 24 percent that year.⁴

This report cites a number of management-related problems which have been uncovered and documented in recent years. Emphasis is on three interrelated areas of interest: (1) Problems associated with administration of HUD housing problems; (2) problems associated with legislative provisions impacting upon effective program administration and examples of how changing circumstances affect program performance; and (3) problems cited in the area of HUD organizational makeup. A final section briefly cites what seem to be dilemmas of administration that diminish program effectiveness.

This report is aimed at briefly surveying some of the types of problems cited above which have been experienced in recent years. It is not intended to be exhaustive and, in many cases, does not consider adequately legislative, administrative or other changes and improvements that have been made to remedy problems which, in many instances, were uncovered many years ago. Rather, it is intended to provide a brief checklist of housing management-related problems encountered and which may or may not be relevant or so serious at the present time.

¹ U.S. Congress, House, Committee on Government Operations, Defaults on FHA-Insured Home Mortgages—Detroit, Mich., 92d Cong., 2d sess., H. Rept. 92-1152, June 20, 1972.

² "FHA Wastes \$4 Billion and Creates City Slums," by George Bliss and Chuck Neubauer (Chicago Tribune article reprinted in Congressional Record, July 8, 1975, p. S12033, daily edition).

³ Summary of Mortgage Insurance Operations and Contract Authority, Aug. 31, 1976. U.S. Department of Housing and Urban Development, p. 8.

⁴ Bureau of National Affairs, Housing and Development Reporter, Jan. 24, 1977, p. 732.

MANAGEMENT PROBLEMS

Problems encountered in the operation of the Federal subsidy programs have been known for many years, although the nature of the problems has changed somewhat over time. In the early 1970's, there was a good deal of concern with management problems associated with the early stages of the mortgage life cycle (appraisals and insurance of defective homes, for example). More recently, there has been concern over and notoriety about problems with the later stages of the mortgage life cycle (management of acquired properties, loan servicing, and property disposition, for example), although concern about problems in both stages has overlapped.

A March 1973 Joint Economic Committee subcommittee report, whose thesis was that "Errors in program management were responsible for most of the failures in both subsidized and unsubsidized housing programs," summarized a number of problems found by Congress, HUD and GAO up to that time. The JEC reported that HUD found in a 1971 sample survey of the section 235 program that about 24 percent of the new homes and 39 percent of existing homes had significant defects. In a related study GAO found inadequately trained appraisers, unusually heavy workloads on appraisers, inadequately supervised appraisers, and a failure of HUD field office personnel to adjust their thinking to the consumer-oriented needs of the program.⁵

In the early 1970's, before HUD modified its guidelines on valuations, the JEC cited the GAO conclusion that in the section 236 program the actual land cost to owners had not been considered as a valuation criterion. For 12 of 47 projects studied, for example, in which valuations were made within 24 months of acquisition by the owner the valuation assigned by HUD ranged between 126 and 137 percent of the owner's cost.⁶

In Detroit, where serious problems of defaults and foreclosures on HUD-backed home mortgages arose several years ago, the Government Operations Committee found that HUD's determination of insurable home values resulted in cases of overpriced homes and, ultimately, in defaults. The committee reported that speculators made large profits on Detroit homes in the period before regulations were revised. A GAO audit of HUD's implementation of the modified cost approach in 11 homes insured in 1971, for example, showed that speculators' actual overhead and profit averaged 49 percent or about \$3,700 a house. The average time that speculators held the houses was 148 days.⁷

The Joint Economic Committee report in 1973 based its conclusion that management problems were at least partially responsible for the subsidized housing scandals in part on a finding that the section 221 (d)(2) and section 203 programs were used in addition to the subsidized section 235 to sell defective homes to program users. In addition,

⁵ U.S. Congress, Joint Economic Committee, Subcommittee on Priorities and Economy in Government, Housing Subsidies and Housing Policy, Report, Mar. 5, 1973, p. 14. A 1971 HUD audit report on the section 235 program found significant problems in the program arising from HUD attitudes on socioeconomic aspects of the program, the quality against quantity of appraisals and inspections, and the lack of effective supervision and review of the work of appraisers and inspectors by middle management. Audit dated Dec. 10, 1971. In U.S. Congress, House, Committee on Banking and Currency, Real Estate Settlement Costs, Hearings before the Subcommittee on Housing, pt. 1, Feb. 22 and 24, 1972, p. 83.

⁶ *Ibid.*, pp. 15-16.

⁷ Defaults on FHA-Insured Home Mortgages—Detroit, Mich., op. cit., p. 14.

FHA operations were found to be more successful in some places (Milwaukee) than in others (Detroit).⁸

In testimony before the House Housing Subcommittee in September 1976 Chicago Mayor Daley pointed out that out of a total of 2,993 HUD-repossessed properties in Chicago, over 70 percent were originally insured under the section 203 unsubsidized program, and 9 percent were section 235 subsidized mortgages. The balance was insured under other FHA programs.⁹

Recent inquiries into HUD's subsidized housing program operations have shown that problems in many phases of the housing subsidy process still exist. The House Government Operations Committee has found a similarity between problems uncovered in 1971 and problems the committee studied in 1975. Among these are long redemption periods, the need for counseling, lack of staff, and the need for forbearance.¹⁰

The Government Operations Committee reported in 1976 that, among other things, GAO determined on the basis of a sample survey that HUD overpaid 60,000 homeowners who reported higher incomes to the IRS than to the mortgagees who recertified their income and computed subsidy payments.¹¹ In addition to this, the committee cited problems of excessive mortgage service handling fees, uncleared audit findings,¹² and an inability to protect abandoned and vacant properties.¹³

Although critical of HUD, the report suggested the complexity of at least some of the problems, including the difficulty of fashioning effective incentives for mortgagees to preserve and protect Government-backed housing.¹⁴ In addition, it was suggested that long redemption periods are affected by State laws beyond the direct control of HUD.¹⁵ It was also suggested that HUD's staffing is affected by OMB priorities.¹⁶

More than one study of subsidized housing programs has cited counseling as a desirable and needed activity, particularly with regard to screening homebuyers. The 1972 report on defaults in Detroit attributed abandonments to unsophisticated homebuyers as well as to defective and overpriced homes.¹⁷ The JEC concluded in 1973 that a comprehensive counseling and maintenance program in Milwaukee at least partially explained the low number of defaults among welfare mothers using the section 235 program.¹⁸ Further, it was argued that counseling might be useful to all low income buyers, subsidized or not, based on FmHA's experience of low defaults under its homebuy-

⁸ Housing Subsidies and Housing Policy, op. cit., p. 12. The report also found that "Initial default experience at 10 HUD field offices under the section 235 program showed variations in default rates ranging from a low of 2.2 percent in 1 field office to about 20.1 percent in another." p. 16.

⁹ U.S. Congress, House, Committee on Banking, Currency, and Housing, Subcommittee on Housing and Community Development, Management and Operations of Federal Housing Administration Activities in the Chicago Metropolitan Area . . . Hearings . . . 94th Cong., 2d sess., Chicago, Ill., Sept. 13, 1976, p. 18. See also tables, *ibid.*, p. 165.

¹⁰ U.S. Congress, House, Committee on Government Operations, "HUD's Responsiveness to Previous Recommendations for Corrective Action," 19th report, Mar. 29, 1976, 94th Cong., 2d sess., H. Rept. 94-968, pp. 12-14.

¹¹ *Ibid.*, p. 15.

¹² *Ibid.*, p. 17.

¹³ *Ibid.*, pp. 19-20.

¹⁴ *Ibid.*, p. 24.

¹⁵ *Ibid.*, p. 13.

¹⁶ *Ibid.*, p. 14.

¹⁷ Default in FHA-Insured Mortgages, op. cit., p. 15.

¹⁸ Housing Subsidies and Housing Policy, op. cit., p. 15.

ers program.¹⁹ The House Government Operations Committee in 1976 recommended that counseling be "available for an provided to low-income homeowners in all HUD programs, not just those in which the homeowner receives a subsidy."²⁰

LEGISLATION—CHANGING CIRCUMSTANCES

While there has been criticism of HUD about perceived management failures and criticism that the housing subsidy programs have not been carried out as they should have been, there have been indications that at least some of the program shortfalls have been due to the design of legislation, to circumstances that change over time making proper administration more difficult than would otherwise be the case and, finally, that the organizational structure of HUD inhibits good management. In this section perceived problems associated with the design of subsidy program legislation and program shortfalls perhaps attributable to changed circumstances are considered. In the next section organizational problems are discussed.

Reference has been made to criticism that HUD has been accused of lax administration of FHA programs in recent years, resulting in cases of defaults, foreclosures, and abandonments. In February 1972 testimony before the House Banking Committee then HUD Secretary Romney defended his agency by arguing, among other things, that the complexity of inner city housing problems and congressional program design were at least partial causes of the problem. Citing the congressionally mandated relaxation of standards in 1968, Romney concluded that:

So we see that the 1968 act was a watershed in defining the objectives and means of Federal housing programs. Virtually every housing provision is permeated with the purpose of expanding housing opportunity for Americans of low- and moderate-incomes, within, as well as outside, central cities . . . and the Act reflects the realistic expectation of the Congress that compliance with its explicit direction to expand and extend old and new FHA insurance programs in the inner city would be risky business for the Agency.²¹

Specifically cited were the enactment of the section 223(e) insuring program for older, declining areas, establishment of the Special Risk Insuring Fund and the directive to administer the section 235 and 236 programs "so as to accord a preference to those families whose incomes are within the lowest practicable limit" for 'achieving homeownership' or for 'obtaining rental accommodations' under the provisions of these sections."²² Later in his testimony, Romney cited a January 1972 National Journal article in which Congressman Ashley stated his reservations about the effectiveness of FHA programs in the urban context.²³

¹⁹ Ibid.

²⁰ U.S. Congress, House, Committee on Government Operations, "Counseling Low-Income Homeowners," 23d report, May 24, 1976, 94th Cong., 2d sess. H. Rept. 94-1187, p. 7.

²¹ Testimony of Secretary Romney in U.S. Congress, House Committee on Banking and Currency, "Real Estate Settlement Costs," Hearings before the Subcommittee on Housing, pt. 1, Feb. 22 and 24, 1972, p. 55.

²² Ibid.

²³ Ibid., pp. 63-64.

Also in his testimony, Secretary Romney cited the multiplicity of factors thought to be involved in the foreclosure and abandonment problems then becoming known in Detroit. These factors included the age of the city, rapid population movement and changes, social deterioration, crime, precarious economic base and "excessively zealous implementation of congressional mandate to insure mortgages on inner city housing for the poor."²⁴

The House Government Operations Committee Detroit Report, cited earlier, found the high rates of defaults and foreclosures resulted from a number of causes, including unemployment and the high incidence of foreclosures among those on public assistance.²⁵

In the section 236 program a HUD audit found a combination of administrative shortcoming and legislative requirements to be responsible for some program problems.²⁶ The audit said, in part, "Inducements to participate in the section 236 program are structured to promote project construction in lieu of promoting long-term ownership. As a result, higher mortgage amounts were insured and interest assistance payments were increased."²⁷ Specifically, it was found that, in some areas, liberal processing combined with inducements like profit and risk allowances and tax benefits to promote construction. With limited dividends, there was little inducement to stay with projects over a period of time. Accordingly, the report suggested the reduction of risk allowances and the raising of returns on investment so that "inducement costs would be paid from project revenues rather than from mortgage proceeds, and improved management encouraged."²⁸

The Joint Economic Committee, which has been critical of HUD's program management practices, has argued that an impediment to good management is the number and complexity of programs. The JEC in its 1973 report cited proposals in the 92d Congress (including H.R. 16704 and S. 3248) to consolidate and simplify housing legislation. "The Congress," JEC stated, "should reconsider enactment of these proposals as part of housing reform."²⁹

ORGANIZATION OF HUD

The precise connection between the organizational makeup of an agency and the agency's ability to carry out its functions is difficult accurately to assess because, among other things, many factors (for example, legislation, leadership, staffing as well as organizational makeup) bear on performance and it is possible, for example, for an organization with structural flaws to operate efficiently. Nevertheless, it is necessary to consider at least some of the commentary on HUD organization to get a more comprehensive view of factors relating to management performance.

²⁴ *Ibid.*, p. 57.

²⁵ Defaults on FHA-Insured Home Mortgages—Detroit, Mich., *op. cit.*, p. 26.

²⁶ HUD section 236 audit findings in "Real Estate Settlement Costs," hearings, *op. cit.*, pp. 151 ff.

²⁷ *Ibid.*, p. 202.

²⁸ *Ibid.*, p. 202. Further discussion of program design problems is contained in "Housing Subsidies and Housing Policy," *op. cit.*, pp. 20 ff.

²⁹ "Housing Subsidies and Housing Policy," *op. cit.*, pp. 12-13.

Two studies, by the House Appropriations Committee and by Horace Bazan for the Mortgage Bankers Association, discuss organizational problems stemming from the HUD reorganization of the early 1970's.

The House Appropriations Committee focuses, in part, on the decentralization of HUD activities to regional and area offices and concludes that effectiveness of the Department has been impaired. "The effectiveness that the Department had hoped to obtain through the decentralization of its operations down to the lowest level has not been accomplished and has resulted in more complexity and difficulty in providing services to the clients. Because of this, several area office officials believe a tendency to expand the supervisory role of regional staffs and the administrative oversight of the central office at their expense is gradually taking place. The management of the Department does not reflect an effective operation that is as responsive to housing needs as might be expected. Instead, in many instances lines of authority are fragmented and confusing, which have resulted in lack of orderliness and consistency. The investigative staff observed that, while most program areas had been relatively decentralized, the administration areas had not. As a result, many field office managers felt handicapped because higher levels controlled not only the funding but also their utilization of personnel."³⁰

The Bazan study for the MBA argues that the reorganization of the late 1960's and early 1970's impaired FHA's ability to act and had serious effects on FHA policy and procedures. Specifically Bazan objects to the giving of roles in FHA policymaking to Assistant Secretaries outside FHA and the splitting up and dispersal of FHA functions.³¹ Cited as an example of reorganization's effect on policy was the placing of responsibility for implementation of NEPA for all HUD to the Assistant Secretary for Community Planning and Management. Because of this, FHA was subjected to heavy burdens of environmental regulations, according to Bazan. Also, Bazan specifically mentions FHA's inability to have an input on a 1973 proposal to employ heavy A-95 requirements in multifamily projects.³² Similarly, Bazan is critical of a HUD decision to replace an FHA procedure on implementing section 223(e). A FHA rule establishing a procedure and the criteria for block-by-block determination of the reasonable viability of older areas "was revoked almost immediately, and a new instruction was issued on May 14, 1971, leaving FHA wholly dependent on property-by-property determinations by an appraiser and with no adequate, systematic means of determining whether an older, declining urban area was, in fact, reasonably viable . . . A decision on FHA underwriting procedure was made at two high a level with inadequate understanding of the underwriting process, the legal requirements, the elements of risk and the probable consequences."³³ Bazan argues that new procedures were imposed on FHA, including equal opportunity and the environment. Bazan criti-

³⁰ Memorandum report on regional and area office structure in U.S. Congress. House. Committee on Appropriations. "Department of Housing and Urban Development—Independent Agencies Appropriations for 1976." Hearings before a subcommittee, pt. 5, 1975, pp. 1135 ff.

³¹ Horace B. Bazan. "The Fragmentation of FHA." MBA, June 1974, p. 22.

³² *Ibid.*, p. 24.

³³ *Ibid.*, p. 25.

cizes the affirmative marketing plan requirement with "a special person outside the underwriting staff to review it."³⁴

Among the possible remedies cited by Bazan are the following:

Procedures should be simplified and stripped of all ancillary requirements not expressly and explicitly required by statute. The insurance of private loans on private property should not be defined as "major Federal actions" under the National Environmental Quality Act. Mortgage insurance should be excluded from the scope of the Office of Management and Budget Circular A-95. Requirements for Affirmative Marketing Plan should be eliminated. Nondiscrimination is required by law. The law should be enforced on a universal basis.³⁵

In Spring 1976 HUD appropriations hearings, HUD reported on management improvements effected recently, including its analysis of various management reforms which might be adopted for the future. Among the issues discussed was the role of the regional organizational level which has been the subject of congressional scrutiny and alternative organizational structures.³⁶

ADMINISTRATIVE CONFLICTS

There are a number of administrative conflicts inherent in the HUD subsidy programs which have made it difficult to administer housing subsidy programs.

(1) A conflict has existed between volume of activity and quality. When a good deal of activity under housing subsidy programs has been sought, there has been a decline in the quality of the product. When, as in the past, the volume of new business has been high, there have been problems of poor appraisals, bad processing, lax supervision and lack of staff where it was needed. When, as at present, there has been a volume of acquired units, servicing, disposition, and management have been problems.

(2) A conflict has existed between direct housing objectives and social objectives. The HUD program audit of the section 235 program found that FHA staff had difficulty in adopting social objectives in implementing the program. The Bazan study pointed out that, if not carefully implemented, environmental laws, fair housing requirements and regional impact requirements could bog programs down in red tape if the organizational framework is fragmented. The Detroit report showed that counseling of homeowners, a social objective, facilitated successful program operation, a housing objective.

(3) A conflict has existed between "hard," business type loans and "soft," subsidized loans. It may be difficult to consistently and correctly apply different standards to the processing of different loans without clearly stated goals. The Detroit report and the foreclosure data from Chicago also suggest that problems in the administration of one program (e.g. section 203) may be attributed to subsidy program difficulties (e.g. section 235).

³⁴ *Ibid.*, p. 27.

³⁵ *Ibid.*, p. 41.

³⁶ U.S. Congress. House. Committee on Appropriations, Department of Housing and Urban Development. Appropriations for 1977. Hearings, pt. 6, 1976, pp. 32 ff.

(4) A conflict may exist between organizational objectives and administrative realities. The House Appropriations Committee report suggests that the HUD reorganization of the early 1970's has eroded so that conflicts in roles and responsibilities in the organization have arisen. A dilemma may exist between centralization sufficient to assure overall goal definition, achievement, and coordination and decentralization sufficient to permit programs to operate successfully on the local level. Another dilemma may involve the degree of functional structure compatible with achievement of program goals.

SHOULD LOCAL GOVERNMENTS BE REQUIRED TO CONTRIBUTE A PORTION OF THE TOTAL COST OF FEDERAL HOUSING PROGRAMS?

(By Barbara O. Maffei, Analyst in Government Finance,
Economics Division, March 31, 1977)

I. INTRODUCTION

This paper examines whether local governments should be required to provide a portion of the total costs of Federal housing programs. The case for matching requirements and the case against matching requirements are presented. Also discussed is what percentage the non-Federal share should be; whether this contribution should be a uniform or variable match; and whether the match should be cash or an in-kind contribution.

II. BACKGROUND

Most Federal grant programs require the recipient to share in the cost of the program or project. In recent years there has been a general reduction in the level of matching required. Increasingly, Federal grants are provided either without matching requirements or with a 66 $\frac{2}{3}$ -percent to 90-percent share of the program costs paid by the Federal Government, rather than the equal sharing that characterized early grant programs. For example, both general revenue sharing and community development block grants have no matching requirements. The Federal Government is authorized to pay up to 90 percent of the costs of the adult education program, and the Federal share for the older American's community service employment program ranges up to 90 percent of the program costs.

In some cases, the matching requirement is uniform; each recipient is required to provide the same amount of matching funds per dollar of aid received. In other cases, variable matching is used to compensate for relative differences in fiscal capacity by raising the requirements for the more prosperous jurisdictions and lowering them for the poorer ones. The actual Federal share under a variable match program generally depends on the average per capita income of the jurisdiction.

Matching shares can consist of cash or in-kind contributions. Cash contributions represent the recipient's cash outlays for the program including any money contributed to the recipient by other public agencies and institutions, private organizations, and individuals as well as Federal funds received under other programs which authorize the use of these funds as the matching share.

In-kind contributions represent the value of noncash contributions provided by the recipient. These contributions may consist of charges for real property and equipment and the value of services directly benefiting, and specifically identifiable to, the grant program. When authorized by Federal legislation, property purchased with Federal

funds may be considered as part of the recipient's in-kind contribution. Standards for calculating in-kind contributions are set forth in Federal Management Circular 74-7, Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments.

III. SHOULD LOCAL GOVERNMENTS BE REQUIRED TO CONTRIBUTE A PORTION OF THE COSTS OF FEDERAL HOUSING PROGRAMS?

Originally, most Federal grant programs were designed with equal sharing between the Federal and recipient government. The great depression of the 1930's brought a change in this grant design. In order to relieve the severe unemployment, Congress departed from the traditional 50-50 sharing and provided large sums to the States, often without matching requirements. Currently, more than 80 percent of the total aid distributed to State and local governments have low or no matching ratios.

A. The case for matching grants

The arguments in favor of matching requirements are set out below:

1. *The lack of a matching requirement always raises the question of whether the recipient government is as likely to be as financially responsible with money given to it as with money it raised itself.*—There seems to be general agreement among the experts that local governments are less careful in attaining efficiency in the spending of money given to them, especially when there is little supervision associated with it. Although this argument is difficult to prove, it is probably of some merit.

2. *The absence of matching requirements, it is contended by many, leads the recipient government to accept a grant whether or not there is a need for the fund.*—This results in Federal funds being used for programs for which there is little public demand and which probably would be abandoned or maintained at a different level in the absence of Federal support.

3. *It is generally believed that matching insures that the local unit will not lower its own support for an activity.*—The provisions of unmatched grants, it is contended, allows the locality to cut spending from its own sources for the aided program or activity. Furthermore, it is felt, this leads to a lack of local interest and a lack of demand for program results. Since the Federal Government is trying to induce the local unit to raise its level of service, the grant, it is felt, should be designed in such a way as to insure an increase, rather than a reduction, in local activity.

4. *There are some who feel that there is no reason for the Federal Government to pay the whole cost of any program or function out of general revenues other than national defenses.*—Since the housing program is divided among the various levels of government, it is contended, the burden for financing the program should be shared among the levels involved.

B. The case against matching

The arguments against matching requirements are set forth below.

1. *It is contended that unmatched grants do not cause governmental units to be financially irresponsible.*—It is felt that it is unlikely that

a government would develop standards of efficiency for the use of its own funds and for the use of granted funds.

2. *Matching grants, it is argued, place demands on increasingly tight local budgets.*—This may have one of two results, both unfavorable. First, the community may have to turn down badly needed funds. In 1975, for example, some Environmental Protection Agency grants, interstate highway funds, hospital construction funds, and maternal and child health funds reportedly went unclaimed because many of the governmental units could not meet the matching requirements. Most of the localities involved stated that they were short of cash and wanted to hold the line on taxes.

Second, the local government may find it difficult to turn down the grants. This can result in other necessary programs being curtailed or stifled and can also result in a distortion of expenditures. As a result, the local budget becomes substantially different from that which would most satisfactorily meet the needs and the desires of the community. Such a result can probably only be justified where the program is essential to the national welfare; in all other cases such a result would be considered objectionable.

3. *Unmatched grants, it is contended, lead to high assurance that a certain program standard will be achieved.*—This occurs because most localities will not turn down "free" funds. Additionally, the amount of the local contribution to the aided function rests solely with the local authorities.

IV. WHAT LEVEL OF MATCHING SHOULD BE REQUIRED

Since most Federal programs have low or no matching ratios,¹ it can be argued that the level of matching required should be kept at a minimum. Matching requirements, in effect, set a "price" on the Federal program. The greater the Federal share provided, the lower the "cost" of the program is to the local government and the more likely the locality will provide the matching share. If the amount of the match required of the local government is "too high," then the locality will substitute other Federal programs where the "cost" or matching requirement of the program to the governmental unit is less. Local governments will search for the most advantageous combination from a matching point of view; that is, local governments will tend to spend their resources on programs with the highest Federal contributions. Eighty-percent money will drive out 50-percent money; 90-percent money will drive out 80-percent money, and 100-percent financing will drive out all other kinds of alternate financing available for comparable projects.

If the matching requirement is too high, then the local unit may be unable to produce the revenues necessary for matching purposes and thereby lose badly needed funds. For this reason, the fiscal capacity

¹ A recent study by the Advisory Commission on Intergovernmental Relations on the intergovernmental grant system found that in 1972 low matching grants accounted for \$25.6 billion, more than 70 percent of the total Federal aid disbursed to State and local governments in that year. The study also found that no matching grants represented \$4.7 billion, almost 13 percent of the 1972 total grants and high matching grants represented only \$1.8 billion, less than 5 percent of the 1972 total grants. The remaining 11 percent of the funds were not classified. For the purposes of the study, a high matching ratio was defined as being at least 50 percent of the program expenditures.

of the locality might well be considered when fixing the amount of the Federal contribution.

There are two types of matching requirements that could be used, variable or uniform. A variable match is one that would take into account the ability of the local government to finance the program. One method of providing a variable match would be to use fiscal effort as measured by the relation between total tax revenue of the jurisdiction and personal income. Such data are readily available since fiscal effort is currently used as a formula factor in the general revenue sharing program. Under the general revenue sharing program, the States and localities with high fiscal efforts receive a larger share of the funds under that portion of the allocation formula while States and localities with low fiscal efforts receive a smaller share of the funds under that portion of the allocation formula. This same principle could be applied to matching requirements for the housing program. The localities with the higher fiscal efforts would have lower matching requirements than the localities with the lower fiscal efforts. For example, for a locality with a greater effort, say 25 percent above the average, the matching requirement could be waived. As the amount of effort dropped off, the higher the required matching could be.

A second method of providing a variable match would be to lower the required contribution for those localities that could demonstrate that they have exhausted their effective taxing and borrowing capacity, thus lessening their fiscal burden. For instance, under the public works grants program, the maximum Federal share of the program costs can range from 50 percent to 100 percent. The actual rate, based on administrative discretion, is set in 10-percent increments within this range on the basis of taxing ability, borrowing ability, unemployment, and median family income in the area.

Another type of matching that could be applied is a uniform matching requirement. Under a uniform matching requirement, each locality would provide the same amount of funds for each dollar of aid received; for example, \$1 from local sources for each \$2 from Federal sources. In the absence of variable matching, generally speaking, poorer localities will have more difficulty in meeting their share of a matching grant than richer localities. Grants with uniform matching requirements are not designed to equalize resources among the units involved. These types of grants can be justified on the grounds that the purpose of the program is to stimulate activity and not equalize fiscal burdens.

The actual level of matching required under the program usually depends upon the anticipated amount of funding. The level of the matching share would vary inversely with the planned funding. The higher the anticipated Federal spending, the lower the matching requirement would be, and conversely, the lower the anticipated Federal spending, the higher the matching requirement.

V. CASH VERSUS AN IN-KIND CONTRIBUTION

The matching share for Federal programs can consist of either a cash or an in-kind contribution. Cash contributions can be either direct or indirect. Direct contributions include revenues raised by the

recipient, contributions received from individuals, institutions, and agencies, and revenues received from other Federal programs which authorize the use of Federal funds as the matching share.

Indirect cash contributions can consist of such things as taxes foregone or tax delinquencies. For example, if a group of houses were to be rehabilitated, the locality could choose not to raise the tax assessments for a specified number of years once the job was completed, thus foregoing additional revenues that could be obtained.

In-kind contributions consist of space, equipment, and personnel. Federal standards require that the in-kind contribution be specifically identifiable to, and directly benefit the Federal grant program. Specific guidelines for calculating the value of these goods and services provided are set forth in Federal management circular 74-7. In-kind contributions are, of course, easier to meet than cash contributions.

A recent Advisory Commission on Intergovernmental Relations study on the Safe Streets Act examined the question of whether there were any differences in the recipient's willingness to provide matching funds and assume program costs when the in-kind match was in effect and when the current cash match requirement went into effect. Under the original¹ act, the maximum Federal share of the program costs was 60 percent. The remaining 40 percent required could either be a cash or in-kind match. In 1971, the legislation was amended.² The maximum allowable Federal share under the program was increased to 75 percent and the required match reduced to 25 percent with a cash requirement of at least 40 percent of the match, 10 percent of the project costs. In 1973, the matching requirement was again changed this time to 90-10 with the 10-percent share coming from non-Federal sources.³ In-kind matching was completely eliminated under the amendment making the required contribution solely cash.

The study found that when compared with the in-kind match, some of the State planning agencies thought that the provision of a cash match resulted in local officials being more cautious with the funds received and that the local authorities tended to review the proposed projects more carefully. This, the State planning agencies believed, resulted in a greater local commitment to the projects involved and more willingness on the part of local officials to assume the program costs later on. Additionally, the study found that even though there are Federal standards for determining the value of in-kind contributions, the cash match was easier to administer. In-kind contributions, according to the study, posed problems of definition, administration, and audit.

It is interesting to note that the study also found that 90 percent of the local government respondents to the survey expressed satisfaction with the 10-percent cash match requirement. There is no reason not to believe that these findings would not be applicable to most other Federal programs.

VI. CONCLUSION

Generally speaking, matching requirements seem to stimulate local government participation and efficiency in administration. While it

¹ Public Law 90-351, Omnibus Crime Control and Safe Streets Act of 1968.

² Public Law 92-644, Omnibus Crime Control Act of 1970.

³ Public Law 93-83, Crime Control Act of 1973.

is possible that such requirements may distort local budget if the required sums are great, this possible distortion should be minimized if the required matching share is set at a low enough level.

Although unmatched grants generally assure that a certain program level will be achieved, there exists a greater possibility than with matching grants that communities who do not need the funds will obtain them anyway. Furthermore, there is no method for recapturing any "extra allotment" that may be received by the community. The widespread provision of unmatched grants probably runs the risk of decreasing the willingness of local authorities to raise their own revenues and thus leads these communities continually to cry for such assistance.

While some communities have turned down so-called "free funds," the number of communities rejecting these funds has been insignificant in relation to the total number of communities that were eligible. Most of the communities have turned down the funds not because the assistance was not needed, but because the requirements imposed were viewed by recipient governments as constituting excessive Federal interference in local affairs. Last year, for example, more than two dozen predominantly white, medium-sized cities with substantial black populations turned down community development block grant funds that they were entitled to because, under the program, local governments must include in their application plans for low- and moderate-income housing. Although there is no matching required, these communities rejected the moneys because they felt the available funds were not worth meeting the Federal requirements established for the program.

The required local contributions as a cash match would be easier to administer. The evidence also seems to indicate that a cash match usually stimulates a greater local interest in efficiency and oversight. The cash contribution could be either a direct cash payment or an indirect cash payment such as taxes foregone. Moneys received by the community from the general revenue sharing program or the community development block grant program could be used to match the Federal funds.

The matching requirement could either be a variable or uniform match. The variable match lowers the requirements for the poorer jurisdictions thus lessening their fiscal burdens. Under the uniform match, which is easier to administer, each community would provide the same amount of funds for each dollar of aid received.

The size of the required match would depend on the anticipated funding level for the program. The higher the anticipated level of funding the lower the required match should be. A range of 10 percent to 20 percent of the program costs might be considered in this case.

THE USE OF BLOCK GRANTS AS A VEHICLE
FOR FEDERAL HOUSING ASSISTANCE

A REPORT TO THE CONGRESSIONAL RESEARCH SERVICE
OF THE LIBRARY OF CONGRESS

(BY JOHN M. FRANTZ, WASHINGTON, D.C., JANUARY 1977)

INTRODUCTION

This report is not written on the premise that a system of block grants is the best approach to Federal housing assistance, or even that such an approach enjoys such support that it will inevitably be tried.

The premise adopted here is that there has already been enough public discussion of housing block grants, and even some actual advocacy of block grants as a substitute for the various housing assistance programs now on the books, that the block grant approach is certain to be actively considered as a possibility in the continuing search for better means of solving our chronic housing problems.

As will be brought out in the discussion of this subject in the main text, the distinction between "block" grants and so-called "categorical" grants is not quite the simple black-and-white matter it may seem to be at first glance. Upon analysis, it appears that there are two basic characteristics which are most descriptive of the practical differences between a block grant system and the more traditional program format:

First, that the grantee has freedom of choice among a wide range of possible strategies and methods for pursuing local objectives, within the broad framework of a Federal purpose but without either Federal direction or review and approval of such choices.

Second, that when the program method or methods selected reach the stage of assuming concrete form as individual projects, such projects may proceed without recourse to a formal system of Federal application, review, modification, and approval, and without having to stand the test of a detailed set of Federal criteria or regulations.

Within these broad standards, the report seeks to construct a concept or approach to the application of block grants to housing assistance which will as nearly as possible meet the basic requirements of political acceptability at the Federal, State, and local levels; administrative feasibility; retention of such Federal control as is essential to responsible exercise of governmental power; and bearable cost. How successful the effort has been is, of course, for others to judge.

JOHN M. FRANTZ.

SECTION I

REVENUE SHARING, BLOCK GRANTS, AND CATEGORICAL GRANTS

For a very long time it has been accepted as a fact of life by many people, and regarded as a matter of passionate faith by some, that most of the ills which afflict or are perceived to afflict American society are traceable to the continuing transfer of power from State and local governments to the Federal Government, or "Washington" (used pejoratively, in this context). Concurrently, in the view of people so minded, local government has been undermined; decisionmaking has moved into the hands of people far removed from the local scene, and thought to be insensitive to local wishes and needs; and the empire of the Federal bureaucracy has grown seemingly without any end in sight.

This is by no means a new or recent concern. Some such apprehensions were clearly in the minds of the founders when they proposed the 10th amendment to the Constitution, reminding all concerned that the Federal Government was one of limited powers, and not a supergovernment which enjoyed all the powers of the States at a higher level of power. The alarm of a great many people was certainly greatly enhanced by the adoption in 1913 of the 16th amendment, which authorized the direct Federal income tax—thereby vastly increasing the financial superiority which the Federal Government already enjoyed over the States by virtue of its broad general power to raise revenues and its exclusive jurisdiction over currency and coinage and over interstate and foreign commerce.

It is quite true that from relatively simple and modest beginnings the Federal Government has grown into one of the largest and most complex political institutions in the world. There were, of course, many causes for this growth.

During the Great Depression of the thirties the Federal Government, acting in large part in response to the inability or unwillingness of the States and localities to act, evolved a whole galaxy of new agencies and functions, most—though not all—of which were in due course judged to be within its constitutional powers. In return for financial rescue, it assumed greatly increased regulatory powers over the banking and thrift institutions. Some of the new agencies and programs brought into being—for example, WPA and CCC—were clearly of a public character. In others, such as RFC, REA and TVA, the Federal Government ventured into commercial and industrial areas which hitherto had been considered the exclusive preserves of private enterprise, subject to such supervision—generally lenient—as the States might elect to impose on them.

Two World Wars and two Asiatic wars of comparable or near-comparable dimensions also compelled the Federal Government to do many things which only it could do: In general, to impose such constraints both on the citizenry and the economy as were necessary to marshal the country's resources in support of its military effort.

Thus, between periods of prewar, war and postwar emergency, and periods of severe economic recession or inflation, the Federal Government has presided over a nation in a state of emergency for many more years of this century than not, and this has had its effect on the

growth both of Federal functions and of government expenditures and employment. Those who view Washington as a sort of whirlpool inexorably sucking political and economic power into the central government are not without some factual basis for their concerns.

There are, nevertheless, a number of readily available facts which suggest that their fears, even if not exactly groundless, are greatly exaggerated. State and local expenditures, debt and employment have grown at rates greatly outstripping those of the Federal Government—especially in employment, since Federal civilian employment has grown hardly at all in recent years, while State and local employment have expanded dramatically. There can be no question that the staffs of State governments and those of a high proportion of counties and major municipalities have increased greatly not only in gross numbers, but also in their levels of skill and professionalism. The States have become active in a wide variety of program areas relatively new to them: Pollution control, environmental protection, statewide comprehensive planning, and State-operated housing programs, to name a few.

The evidence that the growth of the Federal establishment is having a debilitating effect on State and local government, therefore, is hardly persuasive. Nevertheless, those who feel strongly as a matter of philosophy about the Federal threat are persuaded, evidence or no. And there remains the very real fact that the revenue-raising powers and sources available to the States and localities are increasingly inadequate to their growing needs for expanding facilities and services.

These concerns reached prominent expression at the highest level of Government during the administration of President Eisenhower. In a speech at Williamsburg in 1957 and in subsequent messages to the Congress, he proposed a program of progressive reductions in the Federal share of grant-supported programs, and the establishment of a study commission to identify Federal functions which could be turned over to the States, and Federal revenues which could similarly be transferred to help support them. Nothing concrete came of these proposals, however, and the subject continued to rumble in the background until it was highlighted once more by the Nixon administration under the general description of a New Federalism.¹

As is often the case in such matters, the New Federalism contained little in the way of concepts which were actually new. It consisted in the main of the objective of getting rid of so-called categorical grant programs¹ by merging them and generalizing their purposes, and of transferring decisionmaking power in connection with such programs in large measure from Federal officials to the elected heads at various levels of local government. The practical effect of these proposals, in the opinion of some students, might well have been to enhance the influence of the White House and of the Governors, mayors, and other locally elected officials at the expense of that of the committees and members of the Democratically controlled Congress. Some sense of this result may have accounted for the fact that the Congress approached the whole subject of the New Federalism with a degree of uneasiness.

¹ The term "categorical" is generally applied to any Federal grant-in-aid program in support of a specific function or program selected by the Federal Government to receive assistance—such as public housing, loans for veterans' education, soil conservation, etc.

President Nixon did recognize, however, that it would be futile to transfer extensive functions and responsibilities to the States and localities without some means of financing them.² Accordingly, he advanced a proposal that was new—general revenue sharing—and followed that with a number of suggestions for what were called special revenue sharing programs. The distinction between the two forms is an important one.

In general revenue sharing, a proportion fixed by Congress of the general revenues is returned to the States and other local jurisdictions in accordance with a formula, also fixed by Congress. Once in the hands of the recipients, these funds may be used, for all practical purposes, for any or all of the ends for which their own general revenues may be employed, subject only to such accountability as is necessary to assure that the funds are not diverted to uses that are corrupt, unauthorized, or illegal.

Both in concept and in practice, therefore, general revenue sharing may be regarded as a device for revising the entire tax structure of the Nation *de facto*, without the necessity of doing so *de jure*. Even without considering the practical difficulties of revising the tax laws so as to benefit somewhat the less prosperous areas at the expense of the more prosperous—which in general revenue sharing can be accomplished by manipulating the distribution formula—the complications inherent in a simultaneous effort to revise not only the U.S. Tax Code but also those of all 50 States and a vast number of lesser jurisdictions are so enormous that it may reasonably be doubted whether it could ever be done. General revenue sharing accomplishes a large part of the same end by the simple device of having a computer-operated printout machine write checks against a predetermined total according to a predetermined formula.

GENERAL REVENUE SHARING VERSUS "SPECIAL," OR BLOCK GRANTS

Distributions under the general revenue sharing plan, as we have seen, are in substance and effect a revision of the overall revenue-raising scheme of the Nation, with the object of at least partially redressing the imbalance between the taxing powers of the Federal Government and those of the States and local jurisdictions. Viewed in this light, it at once becomes clear that so-called special revenue sharing programs or block grants are of a quite different nature. In either case, what is involved is a payment to one or another local agency out of an appropriation from the revenues of the Federal Government to accomplish a Federal purpose. The Federal Government is thus the prime mover, and the local body is the agent—in a real if not in the technical sense—of that Government for the attainment of a national end. This remains true even when the benefit sought to be conferred is primarily or even exclusively local in character, for it is nevertheless subsumed within a broader purpose which is national in scope—otherwise, the Government would have no reason to undertake the pro-

²In this perception, he was, of course, quite right, as Governor Reagan was to learn when he proposed to turn over some \$90 billion of Federal programs to the States and localities with no clear explanation as to how they were to be funded. Far from being delighted, the prospective recipients of these functions were so alarmed that the Governor thought it best to explain that he had not meant exactly what he seemed to be saying.

gram in the first place. The distinction is a significant one for the further consideration of a possible block grant program for housing.

In the case of special revenue sharing, the term itself is a misnomer. Actual revenue sharing is not involved, notwithstanding that there is a transfer of revenues from one party to another—as, indeed, is true in every case of Federal assistance, whether to individuals or institutions. In fact, a moment's consideration will make it evident that there can be no true revenue "sharing" except in the general sense; moreover, equally by logic and by language, when a purported revenue sharing program becomes "special," it ceases thereby to be general: and ceases also to be revenue sharing in the strict and proper meaning of the term.

SPECIAL REVENUE SHARING VERSUS BLOCK GRANTS

It may be as well to digress briefly at this point in an effort to avoid the semantic confusion which has arisen over the use of the terms "block grant" and "special revenue sharing," and led to the impression on the part of some that they refer to substantive differences in program approach. The first and most important fact is that this impression is groundless. While the legislative proposals under the one designation differed in numerous, sometimes significant, respects from those proposed under the other, these differences related to matters of administration and procedure, not to the substance of the method of financing proposed. In a word, the two terms are in effect two names for the same thing, and in the various bills or titles discussed from time to time the names could have been transposed with no significant effect on their meaning.

This confusion arose more or less by happenstance out of the congressional consideration of the Nixon Administration proposals. As has been noted, that Administration suggested a number of what it called special revenue sharing programs—for community development, for education, and for certain other purposes. It is reasonable to assume that the name was chosen both to link the proposals conceptually with general revenue sharing, which had met with a widespread warm reception, and to keep it within the umbrella of the New Federalism.

While there were differences of opinion between the congressional committees and the Administration on a number of specifics of the proposed community development proposal, the real controversy developed over the degree of review and control over the program to be exercised by the Secretary of HUD, and through him by the Congress. In brief, the Administration sought to obliterate as nearly as possible every vestige of "processing" at the Federal level, which was considered a costly and improper interference with local decisions; hence, the Administration's proposal called for practically nothing in the way of submission of plans and proposals by the localities, or for secretarial review. The committees, by contrast, wanted to retain some formal assurance that the funds provided would be used in accordance with at least some sort of reasonable plan, which in turn would accord with the stated purposes of the statute. They accordingly developed their own proposal which embodied these concepts, and called the funds to be provided "block grants."

In the course of the negotiations which followed, it became clear that ultimately a compromise would be reached which would involve

concessions on both sides, as indeed it finally was. Meantime, however, the terms had become a sort of convenient short-hand, "special revenue sharing" being taken to refer to the Administration's concepts relating to supervision and oversight, and "block grants" to those preferred in the Congress.

Henceforth in this report the term "block grants" will be employed exclusively, since it has achieved the wider acceptance and is more readily understood and also because, as noted above, it is the more accurate term for the technique under consideration.

BLOCK GRANTS VERSUS CATEGORICAL GRANTS

In recent years, and in urban matters especially since the enactment of the massive Housing Act of 1968, it has become increasingly fashionable to deplore the multiplicity of so-called categorical grant programs. Critics vied in their efforts to arrive at high counts of such programs, so that one might read that there were more than 400, or 832 or 1,269, or almost any number one might choose of Federal grant-in-aid programs which were said to be overlapping, conflicting or contradictory, dispersed among a great variety of differently organized agencies, and each possessed of its unique set of regulations, forms, procedures, reviews, and reviews of reviews. All of this was said to be bewildering, frustrating, and costly to local government, and to encourage "grantsmanship," as a result of which the bulk of the funds tended to wind up in the hands of those localities which had the most highly developed skills at threading the multitude of Federal needles available to the knowledgeable.

There can be no question that these evils existed. What is less certain is the validity of the assumption that they were inherent in what were (and are) called categorical grants, rather than the result of poor administration of programs often hastily conceived and incompletely thought through. That assumption was indeed made, however, and went virtually uncontested. Thus it became an avowed purpose of critics on a bipartisan basis, and at both congressional and local levels, to do away insofar as possible with categorical grants in favor of much broader block grants. It becomes pertinent to our inquiry to examine precisely what constitutes a "categorical" grant, and what the significant differences are, if any, between such a grant and a block grant.

Almost immediately after it is posed it becomes clear that this is a much more slippery question than it might appear. A block grant is made to achieve a purpose, and however that purpose is described it must have some boundaries and some content, or else it would be impossible to describe it at all. But this necessarily means that the purpose itself constitutes a "category," if one wishes to look at it in that light.

Thus, a block grant program for housing may quite legitimately be considered a categorical grant for the category "housing." Indeed, virtually any grant program may be considered a "block" grant by comparison with a narrower program in the same functional area. Thus, for example, a program of grants for the planning and construction of hospitals is certainly more "blocky" than one for planning alone; a program for planning and construction of health facilities is still blockier; while grants for health delivery programs

including both facilities and services would be blockier still—although any of these may just as reasonably be described as categorical.

It appears, accordingly, that there is no definitive or precise distinction between categorical and block grants, since they are relative and not mutually exclusive terms. How are we to escape from this dilemma for purposes of the present study?

CHARACTERISTICS OF A BLOCK GRANT PROGRAM

The most promising approach would appear to be to attempt to infer the basic characteristics of what we may feel justified in calling a block grant approach from the difficulties which have been experienced under the more traditional formats, and which are expected to be alleviated or eliminated by a new format. In the main, these seem to involve two broad objectives: to eliminate undue Federal interference in or preemption of local decisionmaking processes dealing with such matters as priorities; and to minimize as far as possible the administrative difficulties, delays and costs inherent in formal processing procedures involving the Federal level.

Working from these broad objectives, it is proposed that a program can be considered a valid block grant approach to the extent that it is successfully structured to meet the following criteria:

1. Initial fund distribution should be accomplished by objective formulae based on statistically measurable factors related to need, not upon a Federal appraisal and approval or modification of local applications supported by showings of need and plans and proposals for local actions.
2. The statute and regulations should accord to the local recipients the widest possible choice of undertakings to be selected on the basis of local priorities and decisions, subject to the overall requirements that any such undertakings be reasonably related to the accomplishment of the Federal purpose for which the program is established.
3. Federal review should be limited to local plans and with respect to them to broad considerations related to the statutory objectives, and not to differences of opinion as to the wisdom or desirability of local priorities or approaches.
4. There should be no processing at the Federal level of applications or plans for individual projects or undertakings within a local program which has been agreed upon and funded.
5. With rare exceptions (to be discussed in later sections), there should be no Federal interference in the execution phase of grant-supported programs. Such interference, where allowed, should be in the enforcement of applicable Federal laws (e.g., equal rights protection, nondiscrimination in employment, etc.), or action to assure the financial integrity or substantive relevance of the programs. In general, such interference, where authorized, should be after the fact and based upon ascertainable factual situations, not upon differences in value judgments made during planning and preparation.
6. The primary function of the Federal Department charged with the program should be to maintain such oversight as is necessary (a) to assure the financial integrity and program fidelity of grant-supported local endeavors, and (b) to keep the Congress informed concerning the progress of the program, its problems, and its cost.

These criteria will be applied in the following sections in considering the problems involved in designing a block grant program for housing.

SECTION II

SOME CHARACTERISTICS OF A WORKABLE BLOCK GRANT PROGRAM FOR HOUSING

Few Federal grant-in-aid programs have functioned in actual practice as effectively as their sponsors had hoped or as their initial administrators predicted; conversely, few have failed as disastrously as their opponents warned. Yet it is clear that some have been more effective over the long run than others, and it is reasonable to assume that this relative record of success or lack of it is related to elements in the conception, design and administration of the various programs.

In this section, an effort will be made to deduce from experience the more significant characteristics which should be built into a housing block grant program to enhance its prospects of success, as well as the other side of the coin: characteristics which should be avoided in order to minimize the likelihood of failure or serious difficulty. Before attempting this analysis we would do well to recall that the whole subject of housing, housing needs, and housing programs is one of enormous complexity, and concerns itself with matters which are in a constant state of flux. Since it is beyond our capabilities to remedy this situation, it follows perforce that we must find ways to live with it. Nevertheless, this consideration will rob any realistic approach of that degree of precision and tidiness which many people find comfortable.

With this preamble, we now briefly review what some of the relevant characteristics appear to be in the design of a block grant program for housing.

A CLEAR AND USEFUL STATEMENT OF THE NATIONAL PURPOSE

It has already been observed that a Federal grant program can only be justified in pursuance of a national purpose. If the only object is to shore up the resources of State and local jurisdictions in dealing with their responsibilities in general—which of course would be a national purpose itself, of sorts—the simple and sensible course to follow would be to increase the general revenue sharing distributions. If, however, the purpose of the program is to achieve a narrower end, and if the Executive and the Congress have agreed upon the nature of that end (which would appear to be a condition precedent to its authorization), then it is clearly their duty to declare it in the least ambiguous terms available.

Duty apart, it should be recognized that the reception and effectiveness of the program will depend to a large degree on the extent to which its purposes meet with general agreement, acceptance and support.

The heading above notes that a statement of purpose should also be "useful." The word is included because statements of purpose have been made in the past which were reasonably clear, but unfortunately not very useful—for example, the so-called national housing "goal"

of the 1968 act, which was certainly not lacking in clarity (26 million units in 10 years, etc.), but which was in fact not terribly useful, since it amounted to a group of production quotas which were not assigned to anyone in particular, but merely left floating in air. This is no doubt in large part the reason for the fact that the 1968 goals, though still formally in existence, have played a less and less significant part in the national housing debate and program-making as the years have passed since their adoption.

It will be observed from the foregoing example that a statement of purpose, in order to be useful, need not necessarily be highly specific; indeed, excessive specificity is more likely to generate problems than to resolve them.

These factors lend to another suggestion: It would be well for the Executive and the Congress to collaborate in the provision of a somewhat more abundant legislative history in connection with the authorization of such a program than is often made available. Too often these documents, especially the reports of the legislative committees, consist in the main in the recitation in paraphrase of the legislative provisions themselves, with little light being thrown on their objectives except in the case of a few specifics which may have been highlighted by controversy or resolved by last-minute compromise. A somewhat fuller documentation should be of value alike to the program's administrators, participants, beneficiaries, and the courts.

The exact formulation of a statement of purpose for a housing block grant program is, of course, a matter of high policy, and must be determined by the Executive and the Congress in the course of the legislative process. For purposes of this report, however, and as a possible starting point in the event that this approach is seriously considered, the following is suggested as a reasonable approximation of such a statement, and a possible basis for discussion:

It is the purpose of this Act/Title to provide an additional means for extending Federal assistance, through methods offering a high degree of local freedom of choice and flexibility in execution, toward the improvement of urban housing conditions generally and the restoration of economic health and social stability in inner cities and in older and declining neighborhoods, with special consideration for the needs of families of low and moderate income.

The reasoning behind the choice of some of the language above, and for the omission of some language not included, will become evident in the course of the further discussion which follows.

ESTABLISHING DIMENSIONS IN SIZE AND TIME

The practical politics³ of obtaining the necessary legislation to authorize a program of housing block grants requires achieving a meeting of the minds among a wide variety of legitimately concerned parties with very diverse views and interests. In the executive branch, these include the program, budgetary, and fiscal authorities, whose sympathies in the matter may coincide but whose perspective and priorities will not. There are also, of course, the committees and

³ It should hardly be necessary to say that the word is employed in a wholly nonpartisan sense.

Members of the Congress. In addition, there are the Governors, the Mayors, and other local public officials, the mortgage-lending industry, the homebuilders, the labor unions, and many more.

It has not been unknown in the past that proposals have been pushed through by organized and energetic support in the face of poorly informed and poorly organized opposition. Where such programs have lacked the support of any broad consensus, their lives have characteristically been short and unhappy—compare Model Cities, for example. The time when this approach to obtaining legislation was wise over the long run has almost certainly gone, if it ever existed.

Two extremes are to be avoided. On the one hand, the program should not be put forward—as some have been in the past—as the long-sought final solution, the answer to the Nation's housing and related urban problems. There are a number of reasons for not making such a commitment: First, because it would almost certainly prove untrue; second, because we have no demonstrable basis for such a conclusion in advance; and third, because people have been burned too often, and would simply refuse to believe.⁴ The chances of developing a program which is all things to all people and localities are vanishingly small; on the other hand, with conviction and effort the chances of developing one which will make a substantial and useful contribution in more situation than not should be reasonably good.

The opposite extreme is equally undesirable: The program ought not to be launched on a minimal basis under the label of a pilot or demonstration undertaking. At least in this writer's opinion, the Congress and the public have been piloted and demonstrated until they are, with some justification, heartily sick of and skeptical about this approach. Few demonstration programs in the field of housing, even if carried through to completion, as many have not been, have succeeded in demonstrating anything which was not reasonably evident in advance, and not a single instance comes to mind of a program which was launched on a pilot or demonstration basis and was later escalated to major dimensions on the basis of its merits as thus tested and established.

The range between a level which would be unrealistically large and one which is unacceptably small is obviously very wide. Unfortunately, there is no interpolated level which is demonstrably more realistic or desirable than another; the choice must be an accommodation of social, political, and financial judgment. In these terms, the level provided as a working assumption for this study—the addition of 400,000 assisted units per year to the composite national program—seems as useful and acceptable as any.

It cannot be objectively demonstrated to be preferable to alternative levels of, say, 500,000 or 450,000 units, or even of somewhat smaller incremental levels. Nevertheless, a 400,000-unit level does have these merits: (a) It is large enough to have an appreciable even if gradual, effect on the overall problem of inadequate housing; (b) it is not so high as to impose an undue financial burden unless the Government considers the whole urban problem one of low priority—in which case, of course, the whole matter would be academic anyway; and (c) from

⁴ The widespread disillusionment following the effusive public launching of the Housing Act of 1968 has not passed from memory.

an administrative point of view it is a feasible level, since it has already been achieved, or at least approximated, during the production-oriented period which preceded the January 1973 freeze. For these reasons, we will adopt for present purposes an assumed level calling for the addition of some 400,000 assisted units on an annual basis.

Volume, however, is not the only dimension which requires consideration in this connection; there is also the factor of time. It is hardly to be supposed that any Congress would make an open ended commitment to an annually increasing program for the indefinite future. Correspondingly, no responsible local body or private entity would expend the money, time, and effort needed to gear up for a program with no assured life beyond, say, the first year. Once again, the possible number of interpolative boundaries between the unworkably short and the unacceptably long is very large indeed.

The simple standard would appear to be one which would provide for a period sufficient to show in the practical test of experience what the potentialities, values, and problems of the program appear to be, and which would then automatically bring about a congressional review and revaluation based on that experience. This test suggests that 5 years is about the practical working minimum. Taking into account the problems of State-enabling legislation, where needed; the establishment and debugging of basic procedures; and the necessarily time-consuming and contentious process of developing local programs to the point of readiness, it is unlikely in the extreme that any significant number of local efforts can begin to demonstrate tangible results—or clear lack of results—in a lesser period; 5 years may, in fact, not be enough. Nevertheless, considering the necessity to assume positive local response and the danger of alienating support through a commitment of too long a term, it is suggested that a 5-year period might provide a workable starting posture for a new program of housing block grants.

SETTING BOUNDARIES

It has already been noted that a new program of this nature should avoid the appearance of being all things to all people. It will help avoid such an appearance to set some boundaries to the program, even while leaving it a wide scope. This will have the additional advantage of somewhat increasing its impact by narrowing the target area a bit.

Assuming that the limits to be adopted must be feasible, significant, and capable of being supported on their merits, several possibilities come to mind:

1. This should be basically an urban program. There are a number of reasons for this conclusion. One, of course, is that it provides a substantial limitation to the scope of the program; one which is readily amenable to administration; and one which would materially simplify the problem of constructing the grant distribution problem and the inevitably difficult problems of intergovernmental relations involved. Second, it should be recognized that the problems of small towns and rural areas are qualitatively different from those of the cities. This is not to suggest that they are lesser, or of less importance. It is rather to recognize that the problems of a small town, unless it is merely a legal fiction which is actually part and parcel of an extended

city, or a predominantly rural area bear very little resemblance to those of a New York, a Detroit, or even those of smaller cities around the country. True, different cities have their own problems. Nevertheless, there are more resemblances than disparities among them. As between them and the small towns and rural areas, there appear to be more differences than similarities. Hence it should be not only convenient but useful to apply separate approaches to them in formulating programs of Federal assistance.

2. So far as possible, the program should avoid displacing or superseding existing programs which have been shown to be effective in meeting special purposes. Thus, the block grant program should not seek to replace the mortgage insurance and guaranty programs of the FHA and VA.⁵

Further, it would be feasible and probably desirable to exclude from the new program projects and other forms of assistance designed especially for, and limited to, the elderly and handicapped. Here again, the existing section 202 loan program has proved itself in operation as effective and workable. Here again also, the problems of designing housing programs specifically for the elderly and handicapped are distinctively different from those of the general population. This, therefore, should offer not a major but a useful limitation on the scope of the block grant program.

3. Housing block grants are an eminently unsuitable approach to the encouragement of new towns, whether in town or in undeveloped areas.⁶ It is true that the Federal efforts in this area have been largely aborted, due in the main to the start-and-stop character of the Federal involvement, and the unpredictability of either Federal interest or support from one period to the next. New towns remain an important area of concern from an overall housing standpoint. It seems certain that enticing private developers into these very large scale and very long range undertakings after the painful experience of recent years will require some new approach, but it is not to be found in the housing block grant concept. How it might be found is beyond the scope of the present report.

The foregoing discussion should not be understood as suggesting that any of the excluded matters should be either ignored or allowed to proceed along existing lines without reevaluation and revision where indicated. On the contrary, if a block grant program were presented in such a context as to suggest that the smaller towns and rural areas and the elderly and handicapped are to be forgotten and dropped overboard, it would be received frigidly, to say the least, in the Congress. Hence, it needs to be stressed at this point that the establishment of limits such as those suggested above makes it imperative that the proposal be advanced in the context of specific proposals for adequate action through other means in the excluded areas.

⁵ Of these, somewhat more will be said at a later point.

⁶ The critical financial problem of these very large undertakings centers around the provision of assured financing or the extended period between the inception of planning and the availability of any substantial cash flow—normally, an interval of several years. The amounts involved are too great to be secured with cash from a housing block grant program, without effectively displacing any other substantial effort in the locality.

LOCAL PROGRAMS AND FUNCTIONS TO BE ELIGIBLE
FOR BLOCK GRANT SUPPORT

A theoretical formula for eligibility for block grant support might provide that grantees could use the Federal funds for any housing-related purpose whatever which is not in itself illegal and for which the grantee agency has authority under State law. Such a broad sweep would accord the maximum convenience to the Federal Government and the maximum gratification to the proponents of local determination and freedom of choice.

Unfortunately, a program quite so open-ended and amorphous would have poor prospects for survival. There is a high probability that it would come to grief in an abundance of projects of dubious value, dissipation of funds without tangible results, and contention over the program's merits, ending in disrepute.

The problem, therefore, is to attach to the program such requirements and limits as are essential to preserve its integrity and basic purpose, while at the same time so limiting these that it remains in fact, and not merely in form, one of local decision and responsibility.

This problem can be attacked in at least four ways: by requirements set forth in the authorizing statute; by authorizing provisions specifying program elements, without limitation to those so mentioned; by the provision of incentives in the form of supplementary grants in support of program approaches considered of especial value in achieving statutory objectives; and by the judicious use of legislative history. Each of these is worth brief elaboration.

STATUTORY REQUIREMENTS

It is almost certainly not wise or practicable to reduce statutory requirements in connection with block grant funds to zero; on the other hand, the very concept of such grants requires that they be kept to a minimum. It is suggested that such requirements (apart from those inherent in the definition of grantee jurisdiction, et cetera) may feasibly be held to two:

1. The statute should require that the local jurisdiction, whether a State or other eligible public body, submit a proposal or plan meeting certain broad criteria. It is not intended that this proposal be approved or devised by the Secretary. The nature of such proposals and the procedure for handling them will be discussed at greater length in section III.

2. It is recommended that the statute specifically require any such plan or proposal to include a significant component of major rehabilitation.

This second requirement is proposed with full recognition that local officials, housing officials and the Congress have been vigorously talking up rehabilitation for many years; that many high resolves and special efforts have been undertaken; and that in fact relatively little has happened.

While all this is true, it does not alter the basic and largely undisputed facts: that the standing stock of existing housing is for many

years will be by far our largest unexploited housing resource; that much of that housing is in a state of progressive decline which, if not arrested and reversed, will ultimately render it not only uninhabitable but virtually beyond rescue; and that this process affects not only isolated units but entire neighborhoods, clusters of neighborhoods, and in some cases a high proportion of the entire residential land area within the city.

Previous efforts at rehabilitation have unfortunately been characterized by a high degree of reliance on rhetoric, not to say puffery. As projects they have tended to be small and highly localized, and pursued with an abundance of caution, if not indeed timidity. Frequently they have been launched under the rubric of "pilot" or "demonstration" projects. Some have failed outright, while some have been brought to an inconclusive completion with little impact on others than their immediate sponsors and participants.

As a result of these and perhaps of other causes, the total volume of Government-sponsored rehabilitation has been negligible, viewed in the perspective of housing needs and problems. Praise and endorsement for the objective have been voluminous; so too, after the fact, have been the commentaries stressing the difficulties, complexities, uncertainties and financial risks inherent in any attempt at rehabilitation on more than a cosmetic scale.

Moreover, it is important to note that economic assessments of rehabilitation have commonly—indeed, almost universally—been made on the basis of superficial and virtually irrelevant economic assumptions. The process and the result have been assumed, quite falsely, to be in all respects analogous to an ordinary business transaction intended to make a profit upon an investment. Thus, regardless of the peripheral language in which it may be discussed, the essential question asked has been reduced to the dimensions of one structure, and to a determination whether the cost of acquisition of that structure plus the cost of rehabilitation yields an increment of value such that the renovated structure can be sold or rented at a profit. In the broader and more significant economic context, the question and its answer are all but irrelevant.

Such a broader context must include the value to the community as a whole of arresting what now appears to be an inexorable trend toward decline, and achieving a perceptible if gradual restoration of health and favorable expectation in older and declining neighborhoods. The rewards of such a successful endeavor are neither predictable nor measurable in monetary terms, except in a very limited way. But it does not seem too much to suppose that they would, over time, improve public morale; raise the tone of living in affected neighborhoods and ultimately in the wider city; create the atmosphere for new economic activity; gradually afford relief to the financial strangulation of local governments and generate a more positive thrust to the motivations of local officials; and even, in time, favorably affect such seemingly remote matters as personal safety, crime, delinquency and vandalism.

If attainable, these are very large rewards indeed, and well worth substantial investment of public resources without regard to the traditional tests of "economic feasibility." If these are the kinds of objec-

tives which public policy should be addressed to, our economic approach to assessing the feasibility of major rehabilitation must undergo radical restructuring.

This somewhat lengthy digression was necessary to make clear why rehabilitation is regarded in this study as an indispensable part of the national purpose which would justify and guide a housing block grant program. We turn now to other elements of program definition at the national level of public policy.

STATUTORY EMBELLISHMENTS OF THE AUTHORIZING LANGUAGE

It was suggested earlier that, apart from requirements per se, the legislative intent and impact of the authorizing statute might be clarified and strengthened through the inclusion of language spelling out some of the kinds of program approaches and techniques authorized to be supported through block grant funds. Such language should, of course, make it clear that authorized uses for such funds are to include, without being limited to, the particulars so specified.

From a policy standpoint, such language should serve to identify areas which the Congress deems to be of particular importance, and in so doing to flesh out the general concept of the statutory purpose without at the same time directly limiting the freedom of action of local decision makers. From a psychological and political standpoint; it should help to highlight these areas and to at least assure that they are not overlooked or given only perfunctory consideration in local planning.

Specific authorizations might provide for the uses of block grant funds for such purposes as:

Acquisition, improvement and sale or rental of residential properties, for occupancy primarily by low- and moderate-income families, including sale or rental at or below fair market value;

Major rehabilitation, including rehabilitation of acquired units for resale or rental as above; encouragement of major rehabilitation by existing or new owners through sale of units at below-market or even nominal prices; loans (at interest rates ranging from market rates to zero, deferred interest plans, et cetera) or grants, or combinations of loans and grants, to finance needed rehabilitation; tax abatement or deferral on property value added through rehabilitation; and the costs of establishing and operating services to provide technical assistance and inspection service in connection with rehabilitation, especially in older or declining neighborhoods;

So-called homesteading programs, with the additional assistance suggested below;

Initial costs of establishing local or regional housing agencies where such agencies do not exist and are deemed needed by the appropriate unit of general local governments; and

Costs of establishing and operating low-cost systems for registration, transfer, and certification of real estate titles.

The foregoing are essentially illustrative. No doubt variations upon them or quite different items may come to mind in the course of developing a specific legislative proposal. The principal point underscored at this stage is the potential value of such a laundry list in the body of the statute itself, both for suggesting the variety and flexi-

bility intended to be embraced in its authorizing language and for pointing the way for grantees toward forms of effort which appear most promising for accomplishment of the overall statutory purpose.

SUPPLEMENTAL GRANTS

The most advanced forms of Federal encouragement of local programs along lines vital to the realization of national policy would be a system of supplemental grants limited to a small number of high-priority local undertakings through block grant funds. This would, of course, be an incentive approach, involving no Federal compulsion; it would, however, for reasons discussed in section III, necessarily involve somewhat more extensive Federal processing and controls.

To make this system workable, it would be necessary for the authorizing statute to set aside a stipulated amount of the total authorization and appropriations of block grant funds. This set-aside amount would not be distributed by formula, but would be used by the Secretary to make supplemental grants upon application by eligible local grantee agencies, for specific purposes authorized. Of the latter, three are suggested here:

1. Local contributions to housing programs, either out of general revenues (relatively unlikely) or out of community development block grants or general revenue sharing payments. A local community would be eligible for a supplemental grant if it allocated and firmly committed a portion of such funds, otherwise available for general uses, to specific application in direct support of a housing program being undertaken with its formula allocation of housing block grant funds. Such supplemental grants would be made according to a fixed matching formula. While there are no specific considerations which can readily be invoked to decide on appropriate proportions for the Federal and local contributions, one-for-one matching seems as reasonable a starting point as any.

It seems too obvious to require elaboration that this form of supplemental grant would be intended to serve two purposes: First, to provide a concrete evidence of the importance the Federal Government attaches to the development and execution of effective local housing programs; and second, to encourage recipients of other and more general grant funds to apply an appreciable portion of them to housing rather than to other purposes, of perhaps lesser priority. At the same time, it allows local jurisdictions a free choice as to whether, in fact, such other purposes are of lesser priority.

2. Encouragement for the establishment of an effective private rehabilitation capability. There can be little doubt that a principal reason for the marginal effectiveness of past efforts at rehabilitation is that there exists no organized skilled, continuing rehabilitation industry to provide the capability of dealing with the special problems inherent in upgrading old structures, including architectural and engineering planning, cost estimation, and the performance of the actual work. In most instances, jobs of this sort are undertaken by underemployed craftsmen in association with others, or by general builders and contractors who temporarily find new construction slack. The former are typically lacking in essential skills and experience, and exhibit a high degree of instability in staff and subcontractor ar-

rangements, as well as a tendency to vanish completely during or shortly after any particular contract, leaving the frustrated homeowner helpless with respect to work undone or wrongly done. The latter are only too quick to drop out of this kind of work when new construction picks up.

It should, in this writer's opinion, be a priority object of public policy in the housing field to encourage the establishment of a residential rehabilitation industry characterized by the availability of firms specializing in this quite distinct area of construction work; equipped with the necessary skills for the planning and conduct of this type of work, and possessing either in-house or through continuing subcontractor arrangements adequate resources for such specialized parts of the work as plumbing, insulation, and electrical installations.

It is necessary for this purpose to draw a distinction between major rehabilitation as here intended and "home improvements," as that term is generally used. Any good sized city is likely to have a considerable number of home improvement contractors, but they do not specialize in or generally engage in the type of work we are here concerned with. Typically, they exist to provide such added amenities as recreation rooms, carpools, modernized and redecorated bathrooms or kitchens, and the like. Many specialize in particular improvements or products, such as aluminum siding, storm windows, reroofing, et cetera. Their market is generally to be found in housing which is at the very least a good grade of standard, and very often semiluxury or luxury housing.

This is not to denigrate the value of such services, but merely to note that they are not relevant to the problem to which this discussion is addressed: namely the capability of designing and carrying out the substantial overhauling of housing which is already drastically impaired and which, if it suffers continuing degradation, will predictably be lost to the housing supply.

It is suggested that supplemental grants be made available to assist in meeting the cost of establishing and operating, through an appropriate local agency (usually an agency of local government) facilities for licensing and regulation of qualified rehabilitation contractors, for maintaining a public register of such contractors, and for a system of inspection of rehabilitation work in progress and upon completion. Conceivably such local programs could extend to the provision of financial assistance, through capital advances or short-term loans at reasonable rates, especially to assist in the organization and successful establishment of new rehabilitation contractors specializing in such work in connection with continuing housing rehabilitation programs undertaken by local authorities, or in older and declining neighborhoods.⁷

Again, there is no objective guidance as to an appropriate division of funding between the Federal and local shares. For simplicity and consistency, a one-for-one or 50-percent Federal share could be used.

⁷ It can be persuasively argued that the function of providing financial assistance for this purpose can best be carried out by a national agency acting through local authorities. If it be so decided, and the functions of licensing, regulation, registry, and inspection are still sufficiently important to justify retaining this category of supplemental grant.

However, in view of the importance of the objective sought it is suggested that a two-thirds Federal share would be justified and might well be more effective. The two-thirds/one-third apportionment has considerable precedent in previous grant-in-aid programs, for whatever that may be worth.

3. *Homesteading.*—The homesteading device is relatively new, and has yet to be applied on a substantial scale. What is notable about the early trials, however, is that in the places where it has been attempted it has been unusually well received by the local people most directly affected. Also, while all the returns are certainly not in as yet, early experience suggests that if properly conceived and managed it offers the promise of a relatively high incidence of success.

Some notes of caution need to be introduced. It is clear that the homesteading approach is not well suited to the needs of the generality of families with extremely low income, or those whose income is mainly or entirely from welfare payments, or those which consist of an unemployed head and some number of dependent children. It should be made clear that to qualify for supplemental grant assistance a local program must include criteria for selection designed to focus it primarily on relatively young families which appear to exhibit a reasonable potential upward mobility as to earning power and other factors conducive to a probable high degree of stability of interest in the acquired home.

A further factor is that homesteading on a significant scale is not practicable in most locations so long as the main source of homesteadable properties is the inventory of FHA-acquired units. While these are in large volume now, they need not necessarily be over time; in addition, they are not uniformly scattered about the country but tend to be concentrated most heavily in a limited number of localities.

There are, of course, other sources available: Properties acquired for tax delinquency, abandoned properties, condemned properties which owners are unwilling or unable to rehabilitate, and properties which the local agency may be able to purchase by negotiation or condemnation. In the latter connection, the Federal standards should forbid the use of eminent domain for the acquisition of owner-occupied one-to-four family structures, or of occupied rental properties in the absence of a fully adequate relocation program.

Like the previous programs suggested as suitable for supplemental grant support, there is no demonstrable division of the Federal and local share which is correct to the exclusion of others. In view of the apparent potential of the approach, however, when applied on a larger scale, it is suggested that this category too might be suitable for a two-thirds Federal share through the supplemental grant.

LEGISLATIVE HISTORY

The importance of an ample, informative legislative history has already been stressed. At the least, it should make clear the legislative intent and the general thinking and purpose underlying that intent in connection with the basic elements outlined above.

There is one other important contribution which legislative history might make, however, which is worthy of mention. This would lie in taking the opportunity to provide the Department with guidance—

indeed, with instructions—concerning the character of administrative regulations which the Congress intends should follow upon enactment of the basic law.

In all too many cases, regulations in past programs, through excessive detail or rigidity, or both, in definitions and in the description of procedural steps and forms, has constructed a legal and procedural overburden on top of the statute itself so complex and time-consuming as to discourage all but the most determined or the most desperate applicants. It goes without saying that such regulations have been issued in the utmost good faith and intent, in an effort to assure that every possible deviation from a predetermined pattern is foreseen and provided for. Be that as it may, they have in the past and could again have serious detrimental effects on program operations, on Federal-local relations, and on the motivation of private entrepreneurs to become program-involved.

It is proposed, accordingly, that the legislative history of a housing block grant program (assuming one is enacted) make it unambiguously clear that the Congress expects the formal regulations issued pursuant to it to be as few, as simple, and as comprehensible as possible, following the rule of thumb that to the maximum extent practicable the statute and legislative history should speak for themselves. While this principle is addressed at this point specifically to formal regulations for publication in the Federal Register, the same basic approach should apply to less formal procedural instructions, operating manuals, and the like.

INCOME LIMITS

A word is in order concerning the extent to which the Federal Government should impose or require income limits in the sort of program described in this section.

In general, the history of past grant-in-aid programs, not only but certainly in the field of housing, has been that income limits imposed by statute and elaborated by regulation have not proved very satisfactory. At best they are and seem fated to be arbitrary and often inequitable, even if only because it is impossible to formulate a rule which has any effect and which also fits neatly the problems of the great diversity of localities involved and the almost infinite variety of human situations encountered among the people affected. On the whole, it would seem best—unconventional as this approach may be—to let the Federal Government remain silent on this question. This would not, of course, inhibit local agencies or units of government from imposing such income limits as seem necessary to achieve program purposes, and are locally manageable in terms of political acceptability and their effects on local people, but the decision on these matters would be transferred to a level at which debate between decisionmakers and program participants is more nearly face-to-face, and where the issues are at least confined to a local or regional area, or in some cases a State, without the necessity of translating them into national standards (complete with exceptions or variations for high-cost areas; areas of high unemployment, et cetera).

Like many useful generalizations, this suggestion appears to be subject to one important exception: it is probably essential that the

Federal statute prohibit the use of block grant funds for any program based upon the provision of housing bearing a "shallow" subsidy—say, the equivalent of a point or a point-and-fraction on market debt service, as is typically the case, for example, in the GNMA-tandem programs of the last few years.

While comprehensive studies and full data are not available, what is known about the operation of these slightly below-market programs strongly suggests that their end effect is to enable otherwise market-capable families to acquire housing of a somewhat higher level of amenities than they might otherwise feel able to undertake. If this be indeed the case, it seems a fair judgment that such programs result in a dissipation of the public funds, without a proportionate contribution either to the general housing supply, or to the solution of housing problems, whether for inner cities, older and declining neighborhoods, or families of low and moderate income. Clearly they are not sufficient to resolve the economic dilemmas of the present rental housing situation.

There can be no serious question that the financial and economic resources available to be focused on housing have their limits, considering competing needs and priorities. This being so, it would seem a matter of elementary prudence to rule out these approaches, which demand heavy capital investment and yield very marginal results at best.

SECTION III

FEDERAL SUPERVISION

THE PRELIMINARY STAGE

In section II we have reviewed in a general and illustrative way the kinds of local programs which may be generated by a housing block grant. This approach was dictated by the fact that the variety of approaches which may be attempted by one locality or another is limited only by human ingenuity, which in a subject area as complex and rich in variables as housing means that the potential number is very large.

Some few Federal standards which need to be built into the authorization structure have been identified. We need now to sketch in more precisely the role of the Federal Government in the execution of the program, once authorized. To do so, it will be helpful to identify the major points of responsibility for decisionmaking, and to indicate the nature, if not the details, of the procedures necessary to link them in logical order. The starting point is the assumption, basic to a block grant approach, that to the maximum extent compatible with the Federal interest and the Government's responsibility to its national constituency the decisionmaking process will start and end at the local level.

INITIAL APPLICATION

It has often been remarked that Congress is reluctant to sign a blank check, and with occasional exceptions this is a fairly dependable rule of thumb concerning the congressional reaction to a legislative proposal that is too loosely constructed. Moreover, the Congress is prob-

ably right. A grant program with no strings attached, involving as it must very large sums of money, is a hazardous business. It is open to incompetence, and it invites chicanery. The problem lies in finding ways to infuse responsibility and accountability into the program without in the process federalizing what was intended to be a program of local decision and execution.

It does not appear excessive to require each local agency seeking to share in the Federal block grant to file an initial application—not for the purpose of establishing legal eligibility, which would flow from the statute, but of demonstrating that the community or the agency has given thought to its problems and has something more in mind than an urge to have access to available funds. For that purpose, the initial application could be required to cover three points:

1. An appraisal of housing need in the area of the applicant's jurisdiction, with special reference to the needs of families of low and moderate income and the extent and condition of older and declining neighborhoods, substandard housing, housing abandonment, and related matters. It should be made clear that this part of the application is not intended to be met with either meaningless generalizations ("our housing needs are many and urgent") or with elaborate statistical analyses and backup reports. The information to make an intelligent and intelligible statement of the problem is, or ought to be, available to any responsible local agency from existing sources, without recourse to special surveys or invoking the aid of consultants. Where this is not the case, the locality should not attempt to leap into a fully active program, but should undertake a survey and planning stage to determine with reasonable certainty what its problems are and what their relative urgency may be.

2. A general strategy and methods plan, describing the major types of attack which are proposed to be made on the problems identified, together with some indication of probable relative level-of-effort to be assigned to each. Again, this description is not intended to be binding upon the local agency either as to precise fullness of coverage or as to the foreseen priorities. Its function, rather, is to substantiate the fact that the community or agency has given enough thought to its problems to have some concrete plans in readiness as to what use to make of funds when they become available.

3. A description of the means by which it is intended to maintain coordination between federally-supported housing programs and closely related functions such as welfare, community facilities and services, zoning, and code enforcement programs. The integral relationship between subsidized housing programs and these related activities is well known to anyone familiar with the subject. Indeed, some have found the relationship so perplexing that they have proposed to treat all forms of housing assistance as in the nature of welfare, and to merge them organizationally at the Federal as well as the State and local levels.

Such an extreme organizational effort at cure is probably unnecessary, and very likely to create more problems than it solves. Nevertheless, it is clear that these closely interlocked activities should not be permitted to proceed independently without reference to each other. Under the theory of the block grant approach, the exact method of

maintaining coordination may well be left to local bodies, but it is justifiable to ask for a showing that such a method exists or is planned.

LOCAL REVIEWS

The initial application should come to the Secretary with the endorsement of the local governing body responsible for the jurisdictional area of the local agency, or, in the case of a State program, that of the Governor. This is not the place to consider other forms of local review and comment that may be required, such as those provided for in OMB Circular A-95.

FEDERAL REVIEW

It is not intended that the Federal Department (here assumed to be DHUD) would review local initial applications for the purpose of approving, disapproving or modifying them; neither is it intended that they would be merely stamped in and filed.

The only ground upon which the Secretary would have authority to reject an application would be a finding that on its face the program described is so unrelated or so slightly related to the statutory objectives as not to fall within even the very broad authority granted by the statute. In the fairly unlikely event that an application were rejected on this ground, the local agency could proceed in either of two ways: it could rework and resubmit the application without prejudice, or it could contest the Secretary's finding in court, no doubt even without any express statutory provision for such a proceeding. It may be presumed, however, that a court would be reluctant to interfere with the Secretary's determination except upon a conclusion that the Secretary had acted arbitrarily and capriciously, and that the challenged determination was not supported by the record.

The Department, however, might well have other objections to the submission on judgmental grounds—for instance, that one or more program proposals are ill-advised or unworkable; that the local agency itself is insufficiently staffed or improperly organized to carry out the proposed program; that the program is not sufficiently comprehensive; or that the proposals are unbalanced by excessive emphasis on one problem or insufficient emphasis on another. In such a case, the Secretary would have the authority to express his reservations and recommendations to the applicant agency, which in turn would be obliged to lay them before the local reviewing and approval authority which originally approved the application. The local agency and approving authority would not be required to accept either the criticisms or the suggestions. They would, however, be required to make some formal disposition of each criticism or suggestion and to advise the Secretary in writing of such disposition, together with the reasons for it. Since at this stage the initiative lies with the local authorities, there is no necessity to establish a time limit for this process.

The receipt by the Secretary of such a formal report on the disposition of criticisms and recommendations previously made would conclude the Federal review at this stage. The Secretary would not have authority to approve or disapprove the disposition actions as a whole or individually. It would simply become a matter of formal record that the local authorities, after reconsideration, had modified their

original plans or had elected to proceed with them, the objections of the Secretary to the contrary notwithstanding.

At this stage, or upon original review of the initial application if no objections or recommendations for changes were thought necessary, the applicant agency would have qualified for participation in the program and would receive its initial grant under the applicable formula.

SUPPLEMENTAL GRANTS

Supplemental grants for special program purposes, as proposed in section II, present a different problem in the matter of review at the Federal level. By nature, these grants are not susceptible to formula distribution, since they are available only upon application and for a specified purpose. This is the basic reason why they would be funded from a special set-aside from the overall grant fund, to be administered at the discretion of the Secretary. It should be remembered too that the local body, under the law as here envisioned, would receive its share of the formula grant as a matter of right, while the supplemental grants are a matter of privilege based upon a showing of special merit.

It seems clear that prudent administration of the set-aside will require a procedure for the submission of an application for funds by a local body to support a specific project or purpose, and for its review and approval, disapproval or negotiated modification by the Secretary. While this may give pain to the staunchest advocates of local autonomy in decisionmaking, there appears to be no way of avoiding it. About the best that can be hoped for is that, considering the tenor and purposes of the program as a whole, the application and review procedure will be kept as simple and as free of redundant review and concurrences as possible.

SECTION IV

FEDERAL SUPERVISION

PERFORMANCE REVIEW

It may be taken for granted that the Congress will insist that it be kept informed as to the results of a housing block grant program, its accomplishments, the problems being encountered, and in general whether the experiment appears to be a success, a dubious proposition, or an outright failure. Only by keeping so informed can the Congress decide whether to continue to authorize and fund the program, to expand it, contract it, alter it, or do away with it in favor of some alternative approach.

Equally clearly, the Congress and its committees cannot assemble this information first hand from hundreds of participating local agencies. They will instead look to the President and to the Secretary for accountability in this broad sense, notwithstanding the limited degree to which the executive branch will or can exercise day-to-day control over local programs and undertakings. It follows, therefore, that the Department's responsibilities in connection with performance review will be both more comprehensive and more exacting than those

outlined in section III in connection with program formulation at the local level.

To remain consistent with the underlying philosophy which we have heretofore attributed to a block grant program, it is essential that the Department's program review functions be focused on the collection of significant information after the fact, rather than through day-to-day participation in program decisions. This in turn suggests that principal reliance should be placed on two lines of review: A fiscal audit capable of disclosing what actually was done with the Federal grant funds received, and a performance audit designed to ascertain what was thereby accomplished.

FISCAL AUDIT

An annual fiscal audit of the program of each participating local agency should be aimed at three basic purposes:

1. Examining, and commenting upon where warranted, the accounting systems, financial reports and financial statements of the agency insofar as they involve Federal block grant funds.
2. Examining, and commenting upon where warranted, all systems of internal control bearing on the integrity of the books of account and the safeguarding of public funds involved.
3. Tracing the flow of cash from the original Federal check through all points in transit to its final application to an authentic program purpose.

The fiscal audit will undoubtedly prove to be one of the most important, if not in fact the most important, means of achieving some assurance to the Department and the Congress of the financial integrity of the program. Given the manifold temptations of a program contemplating a very great variety of uses for large sums of money under a highly restrained pattern of Federal supervision, much assurance assumes critical importance. It should be recognized that this sort of program is not only readily open to abuse, but highly sensitive to any resulting scandal.

If a pattern of abuses and any significant degree of scandal were to develop, there can be little doubt that Congress would react in one or two ways, or a combination of both: first, by drastically restricting the program or even eliminating it altogether; or second, by imposing new and more stringent Federal controls involving an intimacy of Federal participation in program operations which might largely or wholly defeat the original program purpose of maximum decentralization of program planning and operations to State and local bodies. Continuing and vigilant surveillance of financial integrity can, accordingly, be justly considered both as a practical necessity for overall Federal management purposes and a vital form of protection to the continuity of the block grant program and the achievement of its purposes.

These considerations underline the importance of maintaining the audit program not merely on a formal annual basis, but also on a timely and current basis. Accomplishing such a timely annual audit and report for each participating agency would produce a workload beyond the capacity of the Department to perform directly, and probably beyond that of the General Accounting Office, considering its

continually growing responsibilities in other areas. As a practical matter, therefore, it would appear to be necessary to rely on audits performed locally by certified public accountants.¹

Some local CPA firms have experience with engagements involving Federal grant funds; many do not. It would be a substantial contribution, therefore, if the Department were to undertake—perhaps in consultation with the General Accounting Office and the American Institute of Certified Public Accountants—to prepare a standard audit program for housing block grant audits which could be printed and made available to accounting firms undertaking these engagements.

PERFORMANCE AUDIT

The counterpart to the fiscal audit, and of at least as great importance to program management, would be an annual performance audit performed by a team of specially qualified and trained staff from the appropriate field offices of the Department. In this case again, it is a matter of first importance that this program review be launched and maintained on a timely and current basis, and kept that way. Ideally, the review should be so timed that the performance audit team would have the fiscal audit report in hand at the time it began work.

Given a large number of participating local bodies and local programs of widely varying focus and content, this function would also constitute a heavy and continuing workload. Nevertheless, there appears to be no practicable alternative to performing it directly through the use of HUD staff. Indeed, probably the only other resource would be the use of private consulting firms, which to a high degree of probability would be more expensive and less satisfactory. It may be pointed out also that the approach herein considered would relieve the Department of most of the workload involved in the processing of project applications. This alone should help in making manpower available for the performance audit work.

The most important purposes of the performance audit would be the following:

1. To identify the various program elements constituting the local program, and the level of effort associated with each;
2. To measure accomplishment in connection with each element in comparison to local projections or goals, both as to quantity and time;
3. To review the administrative structure of the program from the point of view of clarity of responsibility and assignment of decisionmaking authority at each stage, and of the arrangements for supervisory control, inspection, and quality control;
4. To obtain a qualitative judgment concerning the quantitative measurement of accomplishment, through on-site inspection of assisted program activities; and

¹ It is recognized that this recommendation, if proposed, will generate outrage among the so-called "independent" public accountants. The merits of that argument are out of place here. The essential fact is that in many States the standards of training and responsibility to which independent public accountants are held are appreciably more lax than those for CPA's. The audit program here discussed is important enough that it seems only reasonable to secure what protection is to be had from requiring CPA standing on the part of those who will conduct it.

5. To identify, and where indicated explore and report upon, instances of apparent deviation from or violation of applicable Federal standards (such as fair employment, equal opportunity, et cetera), and recommend measures for the avoidance of conflicts where these may appear to be impending.

The task of evaluating and summarizing these reports in order to keep the Congress informed as to the progress of the program and the incidence of problems being encountered will obviously also fall on the Department.

PERIODIC REPORTS

In addition to the two critical annual reports, the fiscal audit and the performance audit, there will undoubtedly be need for at least some periodic reports from the participating local agencies to provide a basis for continuing statistical series on a national basis. This is regrettable, but probably can't be helped. The guiding principle should be to keep such reports to the irreducible minimum. Massive reporting requirements impose a costly and time-consuming paperwork burden on the grantee agencies. In addition, when they become excessively burdensome they are generally carelessly or perfunctorily performed, with the inevitable result that the central authority finds itself at great effort and expense collecting information which is riddled with errors and inconsistencies, making the national series themselves of dubious value.

CRIMINAL SANCTIONS

Timely fiscal and performance or management audits will go far toward assuring program integrity, but it would be a mistake to rely on these alone. Experience in other housing programs has shown that uniformly good management is difficult to attain, and that fraud and profiteering flourish in an atmosphere of loose or incompetent management. It is not sufficient to take strong measures once abuse has become widespread, as in the case of the so-called FHA scandals: The harm has already been done at that stage.

It is essential, therefore, that the statute include criminal provisions with bite, dealing with such abuses as fraud, false representation, collusion, bribery, kickbacks, and like matters. A vigorous and prompt enforcement program should be instituted from the very beginning, and kept up. In a program dealing with residential real estate, the sensitive points are easy to identify. They relate to such matters as appraisals, bidding and contracting methods, cost reports and certifications, disbursement procedures, property management, and internal controls over cash and bank accounts. These sensitive areas should be the special object of continuing monitoring to protect the public interest and the integrity of the program itself.

The fact that a local program is financed in the main or entirely with Federal grant funds is an amply sufficient basis for asserting Federal criminal jurisdiction for the prosecution of violations which undermine the public confidence in the program as a whole, and there should be no reluctance to assert such jurisdiction where necessary.

SECTION V

THE PROBLEMS OF FUNDING

The question of how to fund a housing block grant program in a way that is both workable and politically acceptable presents problems of considerable sensitivity and difficulty, yet their solution is crucial to the program's possibilities of success. These problems arise at both the local and Federal levels, but as one might expect they are or would be seen from a somewhat different perspective at one level or the other.

At the Federal level, the difficulties arise first of all from the fact that we are seeking to launch and engage in a program which, to be effective, must command a sustained effort over a considerable period. This is rendered difficult and uncertain by the fact that Congress, as a matter of longstanding practice, enacts funding legislation (largely in the form of appropriations acts), on a year-by-year basis. Moreover, to an increasing extent in recent years, the trend in the Congress has been toward enacting major authorizing legislation on a similar basis, requiring its reconsideration and reenactment in each session—a form of "sunset" legislation which goes beyond what even the proponents of this legislative approach would ordinarily think of as ideal.

It is often said that one Congress cannot bind another. In a limited sense that is true. Other things being equal, a law enacted by one Congress may be amended or repealed by a later; a law that one Congress has rejected may be enacted by another.

However sound as a general principle, this rule is nevertheless subject to many exceptions. A constitutional amendment proposed to the States by one Congress cannot be withdrawn by the next because it is of a different opinion. It is certainly questionable whether the power of Congress to declare war embraces the power to undeclare a war, though this has never been put to the test in this form. And the Congress may, and not infrequently does, create long-lasting contractual rights which a later Congress may not abridge without running into constitutional barriers.

There are a number of cases of the latter type in the field of housing. Perhaps the most widely known is the form of annual contributions contracts employed in what is now often called the "conventional" public housing program. In that program, the indebtedness incurred by a local housing authority to build or acquire a public housing project enjoys a full faith and credit guarantee by the United States for the full term of the debt—generally 40 years—and this guarantee runs not only to the local housing authority but to the individual holders of the guaranteed bonds. Clearly, no subsequent Congress could constitutionally abrogate that guarantee, however ill advised it might think it was to have extended it in the first instance. Similarly, under existing law GNMA is authorized to extend a full faith and credit guarantee to obligations issued by certain types of borrowers on the collateral of holdings or pools of specified types of mortgages. No one seriously questions the binding force or the immunity to impairment of these guarantees.

Realistically, therefore, the problem is not that one Congress cannot bind another, but that it is understandably reluctant to do so; in addition, later Congresses are very likely to be annoyed at finding themselves preempted, and while acknowledging their impotence to free themselves of the inherited ties may nevertheless find indirect means of effectively hobbling the offending program.

Since housing assistance is by nature a long-range undertaking, these are among the practical political considerations involved in funding any sort of housing assistance program. Yet since it can only operate over time, it is wholly impracticable to undertake such assistance in discrete annual chunks of authority and funds, with the future left entirely to chance and the changing winds of executive and congressional interest. These are problems which confront the executive in proposing housing assistance legislation, and the Congress in considering such proposals.

Yet another aspect of the matter is the necessity of maintaining financial control over whatever program level Congress does authorize. The Executive Agency or Department, in an effort to fulfill the intergovernmental relations objectives of a block grant approach, may delegate extensively to the local level the decisionmaking process and the choice of priorities among various possible approaches to a local program supported by Federal funds. No matter how far it goes in that direction, however, it is not relieved of the responsibility for financial—as distinguished from administrative or operational—control of these programs, individually and in the aggregate.

These difficulties are also reflected at the local level, but here they are seen in a somewhat different perspective. Clearly, it is both politically and practically very hard for a local agency to plan and initiate a program which is dependent on Federal funds, if there is no assurance of the availability of such funds beyond the initial year. The already complicated problems of local budgeting are further compounded, especially if they involve making future provision for a local share in program cost, whether mandatory or voluntary. Finally, there is the question of the degree of assurance that can be extended, both from a legal and a moral standpoint, to private firms and individuals—whether as participants in program activities (lenders, contractors, and so forth) or beneficiaries (owners or tenants of assisted units) or the local community at large.

Finally, these inherent complications of the funding process need to be considered in connection with three distinct although related stages of the process as a whole: authorization of the substantive program itself; the provision of obligational or contract authority to carry it out;² and the arrangement of cash flow to assure that funds are available to pay off obligations as they fall due on a timely basis. It is necessary to examine each of these stages individually.

PROGRAM AUTHORIZATION

We are concerned here not with the text and content of the program authorization act as a whole, but only with that portion which would authorize the provision of budget authority and appropriations through appropriations acts.

² Or, in the more recent terminology, budget authority.

It has been pointed out before that Congress is most unlikely to grant an open ended authorization for a housing block grant program—or any other, for that matter—without some express limits of total cost and of time period. On the other extreme, authority and funds for a single year would, for perfectly valid considerations, excite considerable speculation and interest at the State and local levels, but little if any activity or accomplishment.

It was suggested earlier that a 5-year initial program might be long enough to provide States and localities with some confidence in program continuity, and not so long as to arouse insurmountable concern on the part of the Congress concerning the limits of the program being authorized and the assurance of opportunity to review and reconsider the block grant approach on the basis of the test of experience.

There are at least two forms which such an authorization might take. Each has its advantages and disadvantages. For convenience, they might be called the single-stage and the double- or two-stage approach, and it will be worthwhile to consider each of them briefly.

The single-stage approach

Under the single-stage approach, the obligational or budget authority provided would be identical with, and in fact would consist of, the appropriations to be made pursuant to the legislative authorization. In general, this report deals only with matters of approach and content, and stops short of considerations of legislative drafting. In connection with funding authorizations however—as well as with appropriations—certain technical matters arising out of the Congressional Budget and Impoundment Control Act of 1974, and procedures adopted pursuant to that act, make it more convenient to present the practical effect of a choice among approaches in the form of examples of the actual legislative language, rather than attempting to characterize it by description, which would be somewhat lengthy and perhaps confusing to the unpracticed reader.³

A decision to adopt what is here called the single-stage approach to be applied to an assumed 5-year period, accordingly, might produce authorizing language in the basic act which would read somewhat as follows:

“For the purpose of making housing block grants as herein authorized, there are hereby authorized to be appropriated during any fiscal year including or following the effective date of this act not to exceed \$ _____, to become available upon enactment, plus additional amounts not to exceed \$ _____ per year to become available respectively on October 1 of each of the next following four fiscal years.”⁴

This draft would signal the willingness of the Congress at the time of its enactment to entertain requests for appropriations within the dollar and time limits stated, and at least its provisional willingness to give the program a 5-year life at its inception. It would not, of its own effect, convey any budget or obligational authority; it would,

³ The factors referred to are not only technical, but a full explanation of them would be lengthy and out of place at this stage. They are, however, very important at the stage of legislative drafting and management.

⁴ This draft is employed for its simplicity and clarity. There are other ways of achieving the same end result. Also, of course, it would probably require some modification to fit it appropriately into its context.

however, provide the basis for the Executive to request and for the appropriate committees of the Congress to consider and act upon appropriations within the limits of the authorization.

The main advantages of this approach are, first, that it is the familiar and conventional way to authorize a program to be funded by annual appropriations; and, second, that each appropriation, when made, constitutes a completed stage in the program funding requiring no subsequent congressional action.

The chief disadvantage is that it would have the effect of appropriating funds considerably in advance of the time when they would actually be spent for work accomplished at the local level, and hence would tend to the accumulation of large unexpended balances of appropriations. This latter circumstance can easily have the effect of causing the program to look ineffective and unsuccessful to the general public or to incompletely informed critics, even though it may, in fact, be proceeding as rapidly as was or could reasonably be expected.

The double- or two-stage approach

As an alternative, it would be possible to authorize the provision of a form of obligational or budget authority other than appropriations as an initial but separate action in an appropriation act, thus permitting the actual appropriations to be sought later and only as needed to meet requirements for current program expenditures. Under this approach, the subsequent appropriations would not be additional budget authority, since they would be made solely to liquidate obligations incurred against budget authority previously granted.

The most common form of such a two-stage approach would be the authorization of contract authority to be released annually through appropriation acts, and to be followed later on the appropriate timing by appropriations to liquidate contract authority previously released.⁵ There is, however, a serious objection to contract authority as a funding vehicle for block grant programs. By nature, it would require the development of new forms of grant contract to be entered into between the Federal Government and the prospective grantees. This would be in itself an expensive and time-consuming process; perhaps more seriously, such contracts in a new area and pattern of relationships can themselves be a source of problems, ambiguities, and potentially litigation. For this reason, the use of contract authority should be approached with caution, not to say reluctance. An alternative device which would appear to accomplish the same ends while avoiding these problems is suggested in appendix A.

The principal advantage of the two-stage approach is that it permits program execution to begin in a circumstance of assured funding, and to proceed uninterrupted within the limits of the established program level, while deferring the need for actual appropriations until funds are needed to actually meet current expenses.

Its principal disadvantage is, in a sense, a counterpart of that advantage: the legislative process of obtaining liquid funds is length-

⁵ It would be possible, of course, to provide contract authority directly in the authorizing legislation, without intervening appropriation action. However, this would be what is generally called "back-door financing," and would quite certainly arouse the vigorous opposition of the Appropriations and Budget Committees of the Congress—an unnecessary, serious, and possibly even fatal obstacle.

ened, throwing additional workload on both the executive agency and the Congress. It is also true that this arrangement sometimes has an irritating effect on congressional committees or individual members, who may feel—even though they may understand the workings of the system—that they are being called upon to perform a ministerial function after the fact, at a time when there is little freedom for the exercise of legislative review or judgment. This is, of course, largely true of the final stage (appropriations to pay for expenses already largely or entirely incurred or committed), though not of the earlier stages of the process.

As noted above, arguments can be made both for and against both approaches. It is important also to stress that either can be made to work successfully. What is essential under either is unvarnished candor by the executive department in dealing both with States and localities and with the Congress as to the workings of the system in use, and the practical significance of each step or stage.

BUDGET AUTHORITY (APPROPRIATIONS)

For the sake of simplicity, it will be assumed in this discussion that budget authority is to be made available through what is called above the one-stage process: i.e., through a series of annual appropriations pursuant to the statutory authorization.

Here again, it will be well to confront immediately the problem of uncertainty, and of the political and psychological effects of uncertainty at the State and local levels, both in the public and private sectors.

It must be borne in mind that authorizing language such as that set forth in the example in the previous subtopic merely provides a basis for the Congress to entertain budget requests up to the stipulated amounts, and to appropriate those amounts—or something less, or nothing at all. The authorizing language does not of its own force mandate the Congress to appropriate anything, in the first or any subsequent year.

If we assume that the authority to actually make grants and commence operations under the program flows from appropriations actually made, and assume further that the first appropriation corresponds only to the first year's authorization, we immediately meet the question which had to be considered in connection with the authorizing legislation itself: how much, as a practical matter, are the States and localities likely to accomplish if there is no assurance except optimism that more than 1 year's funds will be forthcoming?

The realistic answer to this question is, probably very little. To be sure, funds would then be assured for a year of program activity. It is reasonable to think, however, that many if not most local bodies would conclude that the expense and effort involved in gearing up for such a program would not be justified for a one-shot, 1-year undertaking. Moreover, they would have some justification for thinking that the political price of dismantling the whole apparatus in the event future appropriations were not forthcoming would be unbearable.

If these perspectives are realistic, as they appear to be, it follows that some device is needed to provide an assurance of program con-

tinuity with respect not only to basic statutory authority but also with respect to the availability of funds to implement that authority. In a system of annual appropriations, this in turn implies that it will be important, if not indeed essential, that Congress consent to appropriate more than 1 year's authorization at a time, at least in the first instance.

As will be clear from an examination of the illustrative authorizing language provided, Congress could if it chose, acting pursuant to that language, appropriate the full 5-year authorization in the first year. To be sure, at subsequent sessions the Congress would be free to reduce or repeal any of the annual amounts previously appropriated, or all of them, which had not yet become available for obligation. However, the prospect that it would do so would be seen at the local level as being vastly less likely than the possibility of its reducing or even rejecting a mere budget request for a particular future year, if competing demands or budgetary pressures make such actions seem expedient.

It is doubtful, however, that it is either necessary or advisable to attempt to secure 5-year funding for a new program of this type in its first year. In the first place, Congress might well, and probably would, be exceedingly reluctant to go that far in a first step. In the second place, 5-year funding is probably more than is needed to overcome the element of uncertainty at the local level which has already been discussed.

If, for example, the first appropriation were to cover the first 3 years, the States and localities would be looking at a program with an approved life of 5 years which can be launched with three successive years of Federal support already on the books in known amounts to become available at known times. They could hardly ask for more, and it is unlikely that they would. A 3-year funding approach, then, seems appealing from the standpoint of providing some solidity to the assurance of continuity from the local point of view, while not imposing excessively on the freedom of the Congress to maintain legislative surveillance and control.

Such a 3-year appropriation would have to be constructed with care, in order to accord with the restrictive provisions of the Congressional Budget and Impoundment Control Act of 1974 with regard to the provision of budget authority in future years. Although the final language should be carefully checked from this point of view, a provision such as the following would appear to be permissible:

HOUSING BLOCK GRANTS

"For grants as authorized by [standard form of citation], to remain available until expended, \$(3-year total), of which \$_____ shall become available upon the enactment of this Act; \$_____ on October 1, 19—; and \$_____ on October 1, 19—."

In the second year's budget and appropriation round, a fourth-year appropriation would be added, and so on—maintaining a pattern of 3 fully funded-forward program years. This arrangement would serve to underwrite local confidence, minimize hasty planning, and in general be conducive to steady, well-considered program development. It should go far toward mitigating if not eliminating the problems of

program management in a continuing atmosphere of financial crisis—a circumstance that invariably has highly deleterious effects on the quality of both program planning and execution.

CASH FLOW

By cash flow we mean the process of actual fund transfers out of existing appropriations, first from the Treasury to a local grantee, and thence into bank accounts on which checks may be drawn to meet current expenses as they become due and payable. The objective of such a system should be to match cash draws from the appropriation as closely as possible with actual cash requirements from time to time, since premature draws for cash upon the Treasury are reflected in unnecessary additions to the cost of the public debt so long as the Treasury is in a deficit position.

To accomplish this objective, the initial grant pursuant to the applicable formula should be made available to the various grantees not in the form of checks, but in the form of an assured line of credit. The documentation of such a system poses no unusual or unprecedented problems.⁶

Local grantees would then realize cash for operations by means of a system of cash requisitions, based on estimated requirements for a stipulated period. Monthly requisitions would probably be unduly burdensome from a paperwork standpoint; hence, it is suggested that a quarterly requisition procedure would probably represent the best compromise between simplicity and the avoidance of excess idle cash balances in local bank accounts.

Quarterly cash requisitions should be reviewed by the field program officer responsible for the most intimate degree of familiarity with the particular local program involved. While the program officer should not have the authority to disapprove or reduce the local requisition on his own motion, it should be understood that the amount involved is negotiable between him and the local officials where in his opinion it is clearly excessive in relation to a realistic estimate of needs.

FINANCIAL CONTROL

As was pointed out earlier, responsibility for overall financial control of the program will necessarily rest with the Department, regardless of the extent to which program decisions and operating responsibility have been ceded to State and local officials. In this connection also there is one objective of primary importance: that of assuring that no local program becomes overcommitted in relationship to assured financial resources. In this context, "assured" must mean, as regards Federal funding, that the funds relied on have already been appropriated and allocated to the local agency by formula or by exercise of the Secretary's discretion. If local resources are relied upon, the local agency must be willing and able to guarantee their availability when needed.

The necessary implication of the foregoing is a flat requirement that all program commitments undertaken by a local agency with block

⁶ There are some technical questions to be worked out concerning identification of transactions with standard Government accounting principles. These are manageable and can be worked out at a later stage; it seems excessive detail to deal with them here.

grant funds must be fully funded at their inception from funds then available. Unquestionably, this is an uncomfortable restriction on local programing. Its strict enforcement will inevitably generate some friction, but it is absolutely essential to the program's success over the long run.

This principle is the only safe way to avoid "leapfrogging"⁷—an informal name for a process in which program officials incur commitments in anticipation of future action by the Congress: thus putting the Congress in the dilemma that it must either ratify and appropriate for these anticipations, or shoulder the burden of offending the localities by refusing to do so, which in many cases also has the practical result that funds already spent on the particular project have been, to all intents and purposes, wasted.

It should surprise no one that Congress strenuously resents being placed in this sort of bind. It is therefore predictable with a high degree of certainty that a program managed in this fashion will suffer severely for it in due time, either in the legislative or the appropriations process, or both.

The intent of a policy requiring full funding from known sources at the inception, therefore, has nothing to do with considerations of economy, let alone penury; its purpose is that of maintaining the confidence of the Congress in the integrity of the program management and of its system of financial controls. This confidence is a matter of the highest importance to any program which Congress is called upon to finance with Federal funds, and indeed is a prerequisite to continuing acceptance and support.

It will be objected, no doubt, that the requirement of full funding will reduce the volume of assisted housing activity because of the necessity to reserve substantial sums for future requirements, and that it will bias program decisions in the direction of short-term as against long-term approaches.

The first of these objections is clearly correct, but unavoidable by any realistic approach. The second objection also has some validity, but there are two things which can be said about it: First, that more careful exploration of short-term techniques (such as initial capital grants in lieu of long-term debt service subsidies) may not be a bad thing; and second, that with a bit of ingenuity it may be possible to set more realistic time limits to long term approaches, and thus somewhat at least to cushion the effect of the requirement that provision be made for financing them throughout the life of the commitments involved.

ELIGIBILITY AND DISTRIBUTION

In determining what kinds of State and local agencies should be eligible for housing block grant funds; what their jurisdictions would be, and how they might operate either directly or through other bodies or agencies, the objectives should be, it would seem, to establish as simple a pattern as possible, and to leave to local bodies maximum flexibility in working out cooperative arrangements among themselves in the establishment of detailed structures for actual operations. At

⁷ A term invented, so far as I know, by the late Albert Thomas of Texas.

best, the greatest practicable simplicity may be expected to exhibit considerable complexity, considering the bewildering variety of local jurisdictions and governmental bodies which are to be found among the various States.

Consistent with the theory of the program, an appropriate guiding principle should be that the Federal Government should intrude in these matters only to the minimum extent necessary to impose a modicum of order and to minimize as far as possible the difficulty of identifying eligible applicants. Beyond that, the working arrangements should be left to local officials operating within the boundaries of State and local law.

Applying this principle to the problem, one might seek to confine eligible applicants as nearly as possible to four general classes:

1. *States.*—Since it has already been assumed that this is intended to be an urban program, State programs would presumably be directed toward the suburban or metropolitan areas surrounding eligible cities but lying outside the limits of their jurisdiction.

Grants to States would, wherever possible, be made to State housing agencies, where these exist (as they now do in a majority of States).⁸ In States without such agencies, the grants would be made to the State itself (presumably as represented by the Governor) or to such other State agency as the Governor might designate, provided he certifies his finding that the designated agency has the necessary legal authority to accept and utilize such grants.

Obviously, there is a considerable range in the powers, experience, staffing and skills of State housing agencies and of other arms of State government, such as housing and community development departments, economic development departments or agencies, and the like. It should be recognized in advance that this will result in State programs with a wide range of sophistication and effectiveness. Presumably, however, one of the basic purposes of a block grant approach is to stimulate the improvement of State and local capabilities where they now exist, and to encourage their establishment where they do not. Rather than attempting to deal with only the most advanced States, therefore, the hope should be that over time the better-equipped States will still further improve their planning and management capabilities, while the less organized and experienced States will be encouraged to fill in existing gaps and create needed facilities now lacking.

2. *Cities.*—Given once more that what is here contemplated is an urban program, and that reliance in nonurban or rural areas is to be placed (for these purposes) on programs such as those of the Farmers Home Administration, the Farm Credit Administration, and such other approaches as may be thought appropriate, it is suggested that eligible cities be defined as those with a population of 25,000 or more (of which there are, in round numbers, about 1,000). There is nothing magic about this figure, to be sure. It could be lowered to a population of 20,000, or even less. However, it should be remembered in this connection that as the endeavor moves into smaller cities and towns the needs begin to take on a somewhat different character. In addition, the larger the universe of eligible localities, the greater

⁸ It would seem that the Federal Government owes at least this much deference to the State housing agencies, since in a variety of ways it has encouraged their establishment.

will be the dilution of an attainable level of program funding, and thus the more limited the feasible program effort in a particular locality will necessarily be.* Finally, it is desirable to avoid needless overlapping of urban and rural programs as much as possible.

3. *Urban counties and metropolitan governments.*—Eligibility should be extended to urban counties and metropolitan governments, where these exist and where they exercise powers and functions with respect to housing comparable to (or in some cases in lieu of) those of municipal governments.

4. *Regional housing or housing and community development agencies.*—There are not a great many of these, but there is no evident reason not to extend eligibility to those that do exist, provided that they meet the test of possessing the necessary legal powers and of exercising primary responsibility for housing within their jurisdictions.

It will be evident on inspection that instances of conflicting or overlapping jurisdiction will be encountered as between the States or State agencies and such local entities as counties or metropolitan governments. These would relate to the question of who is to do what in certain suburban areas falling within the urban complex of an eligible city but outside its corporate limits.

It is strongly recommended that the resolution of such areas of conflict or confusion be left to the State authorities, and that the Federal Government not attempt to sort them out at the Washington level, by regulation or otherwise. The Government is, of course, obviously justified in requiring them to be sorted out before final eligibility is established, but the task of accomplishing that result appears not to be a Federal function in this framework.

Fixing responsibility

Assuming that a pattern of eligible grantees is established resembling that suggested above, it is at once evident that a great variety of subordinate agencies will be involved at one stage or another in program planning and execution.

A particular city, for example, might elect to conduct the program largely or entirely through the local housing authority—though even in this case various city agencies would doubtless become involved, such as those responsible for planning, zoning, code enforcement, budget, et cetera. Another city might choose to carry out its program through the municipal housing and urban redevelopment department, assuming one exists, or through some other agency or agencies of the city government. Many other possibilities and combinations of possibilities are readily imaginable.

It is proposed, accordingly, that primary responsibility and accountability for the local program rest at the level of the original grantee. The fiscal and performance audits discussed in section IV would, of course, extend to the transactions and activities of all the subordinate or affiliated agencies involved. It would be the original grantee, however, who would bear overall responsibility for the quality and effectiveness of the local program, as a whole, as well as for establishing the ground rules and working out the details of coordination and

*This assertion obviously rests on the assumption—almost certainly correct—that the “attainable level” of funding will be determined by political and budgetary constraints, and cannot be considered to be a dependable multiplier to be applied to the total population covered.

cooperation with and among all the other agencies through which it may elect or find itself required to act.

The effectiveness with which these responsibilities are carried out would, needless to say, be a legitimate and indeed important subject of review, appraisal and comment in the fiscal and performance audits.

SECTION VII

THE GRANT FORMULA

The development of a suitable formula for distribution of housing block grants to eligible classes of recipients, and the portions to be reserved for special purposes (a discretionary fund assigned to the Secretary, and a special set-aside for the supplemental grant programs herein suggested) is beyond the time and resource limits of the present study. An adequate analysis and formulation would require not only as complete a collection as sources permit of relevant demographic and physical data by localities, but in addition access to computer staff and machine time to permit the construction of varying trial formulae and their testing in actual machine runs.

It is possible, however, to suggest some of the considerations which should influence the development of such a formula. For this purpose, it may simplify matters somewhat to reason from the distribution formula adopted for the community development block grant program authorized by title I of the Housing and Community Development Act of 1974. Under this formula, the share of the total funds available for distribution among a given class of recipients which will be allocated to a particular locality or grantee is determined by combining the ratios which certain specified data applicable to that individual grantee bear to the totals of such factors for all grantees in its class. The specified factors are:

Population, as a ratio to the total population of the class;

Extent of poverty, the same, but counted twice;

Extent of housing overcrowding, expressed in the same ratio to total overcrowding.

By inspection, this formula appears to be considerably less than satisfactory as a basis for distributing housing block grant funds. In fact, it appears not to have proved entirely satisfactory for community development grants, perhaps in part because the community development program, largely at the insistence of the legislative committees of the Congress, is somewhat heavily housing-oriented in concept.

In any event, the Budget of the United States⁹ for fiscal year 1978 proposes an alternative formula, which would eliminate the factors of population and housing overcrowding, somewhat reduce the weight accorded to poverty, and introduce two new elements—loss of population (1960-73) and age of housing stock. Clearly this alternative formula appears to move in the right direction, so far as housing is concerned.¹⁰

⁹ As submitted by the outgoing Administration.

¹⁰ It should be noted that this new formula is not proposed to replace the original one. According to the budget, applicants could choose the version which produced the most favorable results.

Elimination of gross population as one determination appears logical on its face. If two cities have the same housing needs in absolute volume, as measured by whatever indices are adopted, it is hard to see why any particular weight should be attached to the fact that one has a larger population than the other. In fact, since both the program under consideration here and the community development program are concerned with land use, gross acreage might be a more significant indicator than population for the purpose of both, if a size factor is thought necessary.

The inclusion of out-migration seems a desirable innovation, in view of its relationship to such problems as housing abandonment and the decline of existing neighborhoods.

Similarly, the effort to give recognition to the problems which appear to be implicit in the age of the existing housing stock is commendable, but it is questionable whether age alone can be considered a reliable guide to these implied problems. In many cities there are neighborhoods or areas of housing 50 years old or older—sometimes considerably older—which are relatively unimpaired and of appreciably higher quality than much younger housing—especially housing built during World War II or immediately thereafter, or during periods of heavy cost-pressure or materials shortages. It seems likely that as the cost of newly constructed housing has pressed progressively more heavily on the ability of buyers to meet resulting prices, a substantial part of the new housing recently built can be expected to age more rapidly than in our earlier experience, unless supported by more intensive maintenance.

To the extent that available data permit, it would be more useful and to the point to attempt measures of what might be called "housing in need of major rehabilitation." Such a category would include housing exhibiting one or more of the following characteristics: Appreciable and progressive structural deterioration; wiring of capacity inadequate for typical continuing load requirements; inadequate or deteriorating plumbing; hazardous or grossly inefficient heating systems; and lack of insulation sufficient for the ambient climate.

It is fully recognized that available housing statistics do not readily lend themselves to the production of accurate indices along these lines. Nevertheless, it should be possible to arrive at some approximation of such a category, and to attempt to refine statistical sources over time to a higher degree of currency and accuracy. Since such data would serve to give a more sensitive measure of one broad and basic problem area to which a housing block grant program should be addressed, such an effort appears very much worthwhile, even in the face of the initial difficulties it would present.

The factor of poverty should probably be retained and accorded some weight, although it is at best very coarsely related to the housing circumstances within a city. An appreciable number of people below the arbitrary poverty line are in fact "adequately" housed, at least by currently accepted standards; conversely, there are large numbers of families slightly above the poverty standard who are not, and have little prospect of improving their condition within the limits of their own resources.

Ideally we would have some statistical measure of families seriously and involuntarily underhoused. No such measure now exists, and the

process of creating it would be long and frustrating. Nevertheless, since this is the problem to which we are ostensibly addressing ourselves, it would seem worth the effort to work toward such a measurement even if, as is certainly the case, it would be a long time in the doing.

Finally, the method of averaging a group of ratios dealing with unrelated quantities to produce an overall ratio seems at best questionable on mathematical grounds, if none other. It would seem more precise and more mathematically justifiable to create a weighted index number for each grantee within a class, and to distribute the funds available for that class pro rata on the basis of the index numbers so derived. Granted, the weighting of elements to arrive at an index number would necessarily be arbitrary, however carefully judgment were applied in the process. But any system of national measures to be used as the basis for an objective uniform nationwide formula is bound by the nature of the problem to be arbitrary, and the index number system has at least the virtue of being arithmetically defensible as a process, however unprovable the results it yields may and indeed are bound to be.

THE GRANT SET-ASIDES

The program discussed in this report contemplates two special-purpose set-asides from the lump sum of budget authority made available for any year for housing block grants. One of these would be a discretionary set-aside for special needs, held and allocated by the Secretary from time to time to meet special circumstances or exceptionally worthy proposals from State or local agencies which cannot be accommodated within their formula grants without excessive distortion of the local program as a whole.

The second is a set-aside, again to be administered by the Secretary, to be used for supplemental grants for the purposes earlier discussed or such other purposes as may be agreed upon in the course of development of the program and the basic authorizing legislation.

Obviously, in the absence of detailed local programs broken down into specific projects, refined cost estimates, and assumed sources of funds—the very approach and process which a block grant program is intended to eliminate so far as possible—there can be no objective criteria to guide what proportion of the funds provided should be assigned to either of these purposes. In a very general way, it may be postulated that these amounts should be sufficient to give their purposes solid effort, and not so great as to impinge excessively on the overall program or keep too great a part of it in the hands of the Secretary and, necessarily, subject to the project application, review, and approval process which the block grant program is also designed to minimize.

Bearing these considerations in mind, and on a purely intuitive basis, it is suggested that of the budget authority made available in any year 80 percent should go directly to the State and local grantees via the formula distribution, and 20 percent to the set-asides. Of the latter figure, the allocation of 5 percent to the discretionary fund and 15 percent to the supplementary grant program seems reasonable and reflective of their purposes.

SECTION VIII

SUPPLEMENTARY AND SUPPORTIVE ACTIVITIES

If it is decided as a matter of policy to go forward with a housing block grant proposal, there is no reason why that should be done as an isolated topic or recommendation, and there are a number of reasons why it should not.

In the first place, it was suggested earlier, and should now be repeated and stressed, that every care should be taken to avoid the appearance of offering this program as a universal solution to all housing problems everywhere. It is not capable of serving as such a universal remedy, and to suggest that it is, even by omission, is to condemn it to failure before it even begins.

In an effort to work out an approach which might offer maximum impact within its assigned limits, we have attempted to focus it on the general housing needs common to highly urbanized areas. In so doing, the program has been tailored to omit, for example, small towns and open and predominantly rural or farm areas. Also omitted from its scope, for other reasons, were the specialized problems of the elderly and handicapped—both those who suffer from inadequate housing and inadequate income, and those who suffer only from the former.

It requires no great degree of political sophistication to foresee that the Congress would accord a very chilly reception to a program which gave even the appearance of ignoring the needs of such groups as these, or worse, of freezing them out of the federally assisted housing program. It follows quickly enough from this premise that the housing block grant proposal can be most advantageously advanced as part of a package which also includes adequate attention to and assistance for those who will not be included in its benefits.

However, in addition to this method of presentation, there are a number of ancillary programs and activities which might well be included in the package, both in order to demonstrate that the approach has in fact been comprehensive, and because these activities are worth undertaking on their own merits and in addition will be supplementary to and supportive of the block grant program in important ways. Some of these will require additional legislation, of a much simpler and less-sweeping nature than the block grants themselves, and others will not. All, however, will require adequate management emphasis and budgetary support. Some important items of this nature are briefly detailed below.

PROGRAM-RELATED ACTIVITIES

FHA-VA Support.—New or amendatory legislation should be included providing for FHA mortgage insurance or VA loan guaranty on the most favorable terms authorized by law in any area designated by a local block grant agency as being an area having special needs and receiving programed assistance under the block grant program. Such a provision would presumably be somewhat along the lines of FHA section 223 (e).¹¹

¹¹ NOTE.—The 1978 budget forwarded to the Congress by the outgoing Administration proposes to terminate new mortgage insurance under this section.

Two caveats, however, should be clearly and emphatically presented in the appropriate combination of legislative language, legislative history, and the tenor of the Department's public statements introducing the program: first, that it is not intended to encourage, far less to mandate, the FHA or VA to underwrite loans which are unsound on their face when measured by the standard of ordinary prudence and good judgment; and, second, that the bind of profiteering and exploitation of inexperienced or uneducated people which went on in some places under 223(e) and 221(d)(2) will not only not be tolerated, but will be met with prompt and drastic action by both local and Federal officials, including both civil and criminal sanctions.

STATE HOUSING AGENCY BONDS

The authority to guarantee the bonds of State housing agencies and to make limited debt service grant payments in lieu of tax exemption with respect to such securities was extended to the Secretary of HUD by section 802 of the Housing and Community Development Act of 1974. It has been little used, and then reluctantly.¹² Regrettably, it was not used to counter the market effects of New York problems on these bonds issued in other areas of the country; had it been, it could have avoided substantial and unwarranted increases in the debt service costs of the State housing agencies which will be with them for a long time to come.

Guaranty of State housing agency bonds is, from a budgetary point of view, an exceedingly economical way of enlarging the effectiveness of these State housing programs. More specifically, for our present purposes it would make an important contribution toward assisting the States in developing effective as well as balanced State programs—a consideration that is as significant at the State level as at the Federal.

Since their share of the housing block grants funds, as conceived here, would go into the highly urbanized fringe areas surrounding the cities, it becomes especially important that the resources of these housing agencies be adequate not only to carry out that aspect of their programs to maximum effect, but at the same time to avoid either the seeming or the fact that this is being accomplished at the expense of other areas and other needs in the State. It is proposed, accordingly, that the bond guarantee program be vigorously pursued, including recommendation of increases of the 1974 authorizations when needed. The latter is not an immediate problem, however, since those authorizations remain largely unused.

A full faith and credit guarantee of State housing bonds would permit these to be marketed at rates only slightly above Federal borrowing rates. It would be well to review whether the authorized debt service subsidy (not to exceed one third of debt service annual cost) in lieu of tax exemption is the most desirable means of further reducing housing costs to the consumer. So far, only \$25 million of the existing authorization of \$110 million has been used, and that only in support of section 8 projects. The latter restriction (a matter of administrative policy, not legislation) should be eliminated.

¹² The 1978 budget previously referred to contemplates no additional activity under sec. 802.

A clearinghouse function.—It is expected that the programs evolved by local bodies under a block grant approach would exhibit a high degree of diversity. This immediately suggests the usefulness of a clearinghouse service at the Federal level to bring to the attention of local bodies throughout the country the results obtained through different approaches—whether strikingly favorable or unfavorable, since it is as important to avoid methods which have proved ineffective as to adapt to local needs methods which have proved workable in practice.

Such a service performed by the department would require no additional legislation. It should, however, be carefully designed with two purposes in mind: First, to rely to the maximum extent possible on the fiscal and performance audits and reports as data sources, and to impose the minimum additional burdens of recordkeeping and reporting on the local agencies; and second, within the bounds of human fallibility, to keep the assessments and reporting of various program models objective and as free as possible from transitory Federal policy biases (such as the pro-section 8 bias, for example).

RESEARCH AND EVALUATION

Evaluation.—The Congress, the local agencies, and the general public—not to say the Department itself—obviously will have a lively interest in a systematic, continuing program of evaluation of a housing block grant program—its accomplishments, costs, problems, and failures where these exist. The establishment and operation of such a system by the Department would not require additional legislation (assuming enactment of the basic authorizing statute), though there would be no harm in making statutory mention of this function as among the Secretary's duties in connection with the program.

The same two caveats mentioned in connection with the clearinghouse function apply here with equal if not greater force. Maximum reliance should be placed on the fiscal and performance audit reports as data sources. In general, local agencies should not be encouraged (let alone required) to keep records not necessary for the efficient administration of local programs. And once more, the Department should endeavor so far as human weakness permits to keep the evaluation program objective, letting the facts speak for themselves rather than interpreting them in the light of departmental preferences. This may well be a vain hope, but vain hopes may sometimes have a salubrious effect, and at least to that extent prove something less or more than vain.

SPONTANEOUS NEIGHBORHOOD RECOVERY

It not infrequently occurs that, for reasons little understood, a neighborhood or even a wider area which has long been in a state of progressive decline more or less abruptly reverses direction and launches itself upon a trend of major rehabilitation, upgrading of property values, and enhanced stability and attractiveness both to residents and to further investment. A current instance of this process familiar to those who live in the District is the upgrading now in progress in the area immediately east of the Capitol.

An even more striking if much older example is Georgetown, which today is considered one of the most desirable areas of the city. Forty years ago it was a slum by any reasonable test.

What we are concerned with here is the phenomenon of such neighborhood reversals occurring on a spontaneous basis, without subsidy and indeed with little or no public sponsorship or support of any kind. Two instances have been cited in the District of Columbia, but there are others in cities about the country. We may legitimately wonder what the causes and mechanics of such transformations may be.

It is proposed, therefore, that the Department undertake a research project aimed at isolating, if possible, what forces are at work to bring such changes about. It should be possible to gain some insights through exploring the motivations of homeowners, owners of rental properties, mortgage lenders, builders or renovators, realtors, and others engaged in this complex process. At most, such an analysis might enable us to understand how to trigger the process on a larger scale; at the least, it should provide greater insight than is now available into the social and economic processes underlying urban decay and the means of arresting or reversing it. Such a project would not be inordinately expensive, nor would it require any new legislative authority. The relevance of the results, if any are forthcoming, to the uses and administration of a housing block grant program are too evident to require elaboration here.

HOUSING STATISTICS

In discussing the problems involved in constructing a distribution formula for housing block grants, mention was made of the chronic deficiencies in available housing statistics series.¹³ Given that the objective is to help solve housing problems and relieve housing needs in localities throughout the country, it would clearly be a matter of the greatest convenience and utility if such problems and needs could be measured with some reasonable degree of accuracy, both in national magnitudes and locality distribution. Present official data are amenable to this result only through a fairly elaborate—and hence to a degree tenuous—series of extrapolations and estimates.

No one who is at all intimately familiar with this problem is likely to underestimate the difficulties involved in the seemingly simple task of improving the utility of statistical series in housing. Housing economists and statisticians in HUD, Census, and elsewhere, have struggled with these questions for many years, with what may be thought, at best, indifferent results. It would, therefore, be fatuous to proclaim in advance or even to greatly hope for revolutionary and rapid progress in this area.

Nevertheless, the problems of producing data which are more sensitively related to the problems of public policy and to the consequent process of program formulation are not inherently insoluble, and the results could be exceedingly valuable. There appears to be a natural duty on the part of HUD to exercise as much leadership as possible in the effort to bring this about. Here again no legislation is required,

¹³ For example, in the 1970 census, substandard housing was considered to be that lacking one or more major interior plumbing facilities—a criterion which for present purposes is not only obsolete but downright archaic.

unless it be an admonition to the planners of the 1980 and subsequent censuses to give increased attention to the utility of the data collected for public policy formulation and program development, as well as its purely informational aspects.

If indeed we know what we are trying to do, it does not appear a hopeless task to infer from that the kinds of data which would be helpful in doing it. At the very least, we should continue to try.

TECHNICAL ASSISTANCE IN LEGAL MATTERS

Like other programs conducted through bodies of general local government or specialized local agencies, the scope as well as the effect of local programs under the block grant program will be influenced and in some cases limited by State and local legislation. There is little uniformity among existing statutes and ordinances in this area, and it would no doubt be unrealistic to pursue uniformity as an objective in and of itself.

Nevertheless, the existence of even some standard conceptual threads in at least a high proportion of the jurisdictions involved would be valuable in attempting to understand or evaluate what is or is not undertaken or accomplished in local programs. It might also spare some States or local bodies the burdens of avoidable litigation in an appreciable number of situations.

It is suggested, accordingly, that the Department might well take on as one of its contributions to the national program the drafting of model State enabling statutes and local ordinances designed to facilitate the planning and conduct of local programs and to avoid difficulties which experience has shown may be encountered, taking into account the developing case law which will arise around this as around other governmental undertakings. No legislation is required for this purpose. As with the matter of housing statistics, results would be achieved in this area only over a considerable period of time, but if the effort is pursued with vigor and imagination the results should, in time, prove well worth the effort. Past experience has shown that technical assistance from the Federal level in these matters, if not approached in a heavyhanded manner, is generally welcome and can have substantial influence.

SECTION IX

ADMINISTRATIVE FEASIBILITY, COST, AND BUDGETARY IMPACT

There remain to be examined two very broad and basic questions: Would such a program be feasible from an administrative standpoint? And what might be its cost and budgetary impact, in the short and somewhat longer range?

Like any questions which turn on the unpredictable behavior of large numbers of people and institutions—not to say the future of the economy as a whole—these questions do not admit to precise measurements or answers, any more than does the future behavior of the stock market. Nevertheless, it is essential to at least explore them and consider what the reasonable probabilities appear to be.

ADMINISTRATIVE FEASIBILITY

There is no evident, decisive reason to conclude that a housing block grant program as envisioned in this discussion would not be workable from an administrative standpoint, either at the Federal or at the State and local levels. This is far from saying that it is assured of success; it merely says that it is not foredoomed to failure because of being inherently unmanageable.

In order for the program's management to succeed well enough to achieve a workable level of congressional and public acceptance, it is necessary to make two major assumptions, either of which may be thought by some to be excessively optimistic:

First, it must be assumed that the Federal establishment is capable of achieving a hitherto unreached level of sophistication in the inter-governmental relations involved in planning and carrying out the housing block grant program. The Department, and the administration of which the Department is merely the principal agent, must cultivate and adjust itself to keeping its hands off the levers of control, and confining itself to technical advice and assistance which is actually that, and not a disguised method of preempting or forcing revision of local preferences and decisions. Administration by Federal Register must be forgone.

This proposition has a concomitant aspect. The Federal agency must adjust itself, simultaneously with this rather relaxed approach to programing, to a firm, stringent and continuing surveillance designed to assure the integrity of local programs insofar as they involve Federal funds—to guarantee, so far as that is possible, against the occurrence of scandal on any significant scale. Yet this surveillance program itself must be conceived and conducted through arms-length mechanisms and procedures which do not bring about excessive intimacy of Federal involvement in local operations. The manifold forms, regulations and reports of, for example, the welfare programs must be renounced from the inception—not only as an administrative objective but as even an acceptable form of manifesting a Federal presence at the local level.

The fact that no Federal grant-in-aid program has ever been administered in this fashion is insufficient proof that one cannot be, inasmuch as it has never been tried on any such scale or with any such degree of philosophical consistency. But there can be no blinking the fact that it would be exceedingly difficult, going as it does against the Durante rule.¹⁴ It would require a high degree of understanding and leadership on a continuing basis both in the Executive and legislative branches. It is quite possible that in the end it would collapse under the burden of minor or major frustrations, annoyances, disappointments and political squabbles. The possibility is less than a certainty, however, and seems an insufficient threat to rule out at least a serious effort to make it work.

The second indispensable condition is full recognition at the beginning and as matters develop that there is a very wide range among the States and local agencies with regard to organization, legal pow-

¹⁴ Namely, everybody wants to get into da act.

ers, professional staffing, experience and knowledge, and the extent of prior planning available to lay the foundations for such a program. There is no immediate or even early cure for these discrepancies in readiness, yet the Federal Department lacks (and should not seek to exercise even if it possessed) the ability to separate these sheep and goats, extending need to the meritorious and denying it to the unready.

To a degree this problem might be self-limiting, in the sense that the least ready grantees might as a matter of prudence refrain from applying for funds greatly exceeding their capabilities to use sensibly, thus leaving balances available to be redistributed to more advanced claimants. At best, however, this could only mitigate the problems, not eliminate them.

It follows, therefore, that it must be assumed and recognized that one of the basic objectives of the program itself is to strengthen local capabilities where they exist, and call them into being where they do not, through the force of necessity and experience. The Federal Government's tools to exert leverage on this process would and should be limited. They would consist mainly of technical advice and assistance provided on request, the sort of clearinghouse service earlier suggested, and the force of local public opinion and local political processes reacting to the factual reports and comments provided in the Federal fiscal and performance audits, which presumably would be made available widely, not only to the local agencies themselves but to the general public in the areas affected. Also an important influence would be the periodic reviews of program progress by the Congress.

These are potent tools, but they are also slow acting. It must be assumed, accordingly, that for an extended period the national program taken as a whole, will look very ragged, and it will be necessary to refrain from jumping to the conclusion that the most ill-equipped local bodies are failing simply because they are accomplishing significantly less or moving much slower than their readier counterparts in other areas.

If these two major conditions can be met, the problems of program management, though they will be many, are not beyond solution. It may be that as a nation we are not yet ready for the degree of patience, tolerance and cooperation which such a program would demand. No amount of introspection will tell us whether this is so; the only sure way to find out is to try it.

COST AND BUDGET IMPACT

The cost of such a housing block grant program is, of course, largely a function of the magnitude of the effort. It was proposed in the working instructions for this assignment that a program objective of 400,000 assisted units per year be used as a given assumption. Such a level appears suited to the need to avoid the pitfalls of a program so large as to fall by its own weight, or so small as not to provide a realistic test of the approach.

It would be something to think that there is a convenient, objective and demonstrable way to assign a cost factor per unit which could then be multiplied by 400,000 to determine a total annual commitment to maintain a program at this level. Unfortunately, this is not the case

for a number of reasons which cannot be simply ignored or wished away.

In the first place, even among existing HUD programs of housing assistance the average actual subsidy paid per year, per subsidized unit, ranges very widely, as a glance at table 1 on the following page will reveal. In fact, between the lowest unit figure and the highest in the actual year 1976 the range is almost 800 percent.

What do these figures mean? It is almost impossible to say.

On the one hand, they do not necessarily mean what they seem to. For example, the figure shown for local housing authority-owned public housing is biased downward by the fact that the program includes a very heavy component of projects built in earlier years at lower construction costs and financed at much lower interest rates than those prevailing now. On the other hand, it is to some extent biased upward by the large numbers of welfare families and families with little or no income which have accumulated in these projects, limiting rental income and leading to increased subsidy payments. The figures for section 8 are suspect because the number of completed units is too small and the experience too recent to be necessarily reliable. And so on. Even the average figure is useful only to think about rather than as a guide to anything, since mathematically it implies a perfectly uniform program in which the same number of units would be provided under each program—an impossible circumstance in actual practice.

As if that were not enough, there are innumerable other ways of reducing current housing cost to families of low, moderate, or lower-middle income which are not represented in these figures. Some examples are: initial capital contributions in whole or in part; use of balloon-type mortgages with deferred principal; partial or complete real estate tax exemption for certain types of projects, or units, or improvements; use of loans at below-market interest or at no interest rate; donations of land, or materials, or both. Ingenuity will contrive many others. Moreover, these devices (and others) can be used in all sorts of combinations. Some will result in recouping a portion of the public investment over time (as in the case of loans, regardless of interest rate); others will not, as in the case of debt service subsidy plans over all (or part) of the life of a mortgage.

TABLE 1.—AVERAGE SUBSIDY PAYMENTS PER UNIT FOR EXISTING HUD HOUSING ASSISTANCE PROGRAMS

[In dollars]

	Actual, fiscal year 1976	Estimated, fiscal year 1978
Rent supplement program.....	1,212	1,488
Sec. 235:		
Original program.....	439	414
Revised program.....		918
Sec. 236.....	1,195	1,291
Public housing program:		
LHA owned.....	1,156	1,450
Leased (sec. 23).....	1,640	1,768
Sec. 8:		
New or substantially rehabilitated.....	3,380	3,760
Existing.....	1,782	2,000
Average (universe of 1 unit).....	1,543	1,636

Source: HUD factors used in compiling fiscal year 1978 budget.

What all this means is that, given an unknown but large number of participating grantees who are free to select among a large number of housing assistance techniques or combinations of techniques, it is quite impossible to devise a set of assumptions which will produce a demonstrable or even relatively reliable prediction of total cost, either in terms of gross outlay or net final expenditure. To be sure, such assumptions can be made and models constructed, but this is a game which any number can play. Except for the more extravagant flights of fancy, anyone's model is just as valid or invalid as another's; hence, there is no ground for choosing between them except for one's preference as regards the result obtained.

If this route of access is hopelessly blocked, as it appears to be, we have little choice but to attempt to approach the problem from a different direction.

Accordingly, this analysis will be based on the assumption that a mix of programs can be developed by the State and local bodies which will result in varying forms of assistance at an average cost per unit of \$20,000. It should hardly be necessary by now to say that the selected figure is not arrived at by calculation for an assumed program mix. The amount of \$20,000 is chosen as being of a reasonable order of magnitude as the possible average of an unknown mix; as being small enough to yield a bearable total program cost, and large enough to constitute a substantial contribution toward mitigating effective housing costs to families of low or modest income.

While the \$20,000 figure may fairly be described as in a sense an arbitrary choice, a few statements can be made about it which at least suggest that it is not entirely unreasonable. Thus, \$20,000 is—

Approximately two-thirds of the carrying cost or debt service on a modest house for the average life of a home mortgage;

Approximately one-half the rent on a family unit for a similar period;

About three-fourths of the initial cost of a modest existing house or a new rental unit not in a high cost area; and

Roughly equivalent to the net acquisition cost of a deteriorated unit acquired for major rehabilitation and resale at a written down value.

These statements are not made to suggest concrete applications of an average \$20,000 investment, but rather to give some perspectives which may help support the view that, though arbitrary, it is neither unreasonably large nor small.

The cost of monthly subsidy tied to debt service (as in section 236) over a long period would substantially exceed \$20,000. Given that such methods are permissible, the assumption of a \$20,000 average implies the further assumption that to the extent such larger commitments are attached to portions of the program, they will be offset by the use of more immediate short-term approaches which will serve to restore the average. If this secondary assumption proves erroneous, of course, the natural result would be a reduction in the total number of units produced at a given national program level.

If the assumption of \$20,000 average is taken as valid, or at least as useful, for present purposes, then the cost of a 400,000-unit program becomes a simple arithmetic product: namely, \$8 billion. This

is also the annual level of budget authority required for a continuing program of 400,000 units per year.

In time, no doubt, this assumption could be modified realistically on the basis of accumulated experience. It would be unwise, however, to do this on the basis of experience in the first 1 or 2 years, since this would be likely to prove unrepresentative both as to the mix and as to the costs achieved after the necessary shakedown period to which all new programs are subject.

BUDGETARY IMPACT

Estimates of budgetary impact over even a short series of years cannot be arrived at without making some set of assumptions, and necessarily the margin of possible error increase with the number of assumptions made. Nevertheless, if the assumptions are not inconsistent with each other and not in conflict with such facts as are available, they can be manipulated so as to present a reasonably informative and useful projection of the budgetary considerations which must be weighed in connection with a proposal. Such an estimate has been made for the block grant program described in this report. The results appear in table 2.

The two major budget factors which attract the greatest interest are budget authority—a measure of the total financial involvement being undertaken in initiating or continuing a program at a given level—and outlays, which represent the actual net funds withdrawn from the Treasury during a given period, directly affecting the budget deficit or surplus for that period under present budget concepts.

As the program outlined here is constructed, the budget authority required is obvious: \$8 billion per year, for a total of \$40 billion for the 5-year period. To be sure, these are large figures, but efforts to make them look smaller by recognizing only a portion of the necessary authority at the inception have proved to be self-defeating in the past. It is not only in accord with the trend of present practice but also better for the program in the long run to swallow the big figures at the beginning. If the Congress is unwilling to do so, it may be that the particular problem of public policy involved—in this case housing and the decline of the cities—does not really enjoy as high a priority as the rhetoric on the subject would suggest.

It is in the process of estimating outlays that the various assumptions made come into play. In working out table 2, recognition has been given to the rule of thumb that it will actually take longer to do almost anything than you think it will in advance. The more specific assumptions built into table 2 are listed on the next page.

It will be noted that outlays, unlike budget authority, tend to start at relatively modest levels in the earliest years, and to expand as the program matures and plans are translated into operations. Thus in table 2 outlays for the first program year are estimated at less than \$800 million, growing by the fourth and fifth years to approximately \$6 billion. This rate of growth would leave nearly \$20 billion remaining to be spent at the end of the 5-year period, assuming authorization of the full, 5-year \$40 billion program, even if no further authorizations were made for the sixth and subsequent years.

TABLE 2.—ASSUMPTIONS USED IN CALCULATING 5-YEAR BUDGET IMPACT

In addition to the assumption of a 5-year program authorization at \$8 billion per year, of which 3 years at \$8 billion each would be released in the first year's appropriation act, table 2 reflects the following more specific assumptions as to program characteristics:

1. Twenty percent of available funds in each year to be applied to forms of long-term continuing subsidy of the rent-supplement or interest-rate-subsidy type, averaging per unit \$133 per month for an average period of 15 years.

2. Twenty percent to be applied to similar arrangements with a somewhat deeper subsidy and longer term, averaging \$200 per unit per month for 20 years.

3. Fifteen percent to be applied to various forms of supplemental grant undertakings in which one-half would be spent in the year following commitment of one-half in the next year.

4. Fifteen percent to be applied to immediate expenditures (such as initial capital contributions) disbursed in the year of commitment.

5. Thirty percent in various arrangements producing expenditures over a 2- to 4-year period.

Amounts recaptured (from sales of property, loan repayments, et cetera) are disregarded on the theory that they would be reused, with a net zero effect.

NOTE.—The assumed long-term arrangements (Nos. 1 and 2 above) would yield approximately 100,000 units per year. On this basis, the remaining program would have to average about \$16,000 expenditure per unit to produce the assumed 400,000 unit program.

TABLE 2.—HOUSING BLOCK GRANTS—5-YEAR PROGRAM: BUDGET AUTHORITY AND ESTIMATED GRANT COMMITMENTS APPROPRIATIONS, AND EXPENDITURES

[In millions of dollars]

	Program total	Years					Total 5 yr	After 5th yr
		1	2	3	4	5		
Obligations:								
In year		4,000	8,000	9,000	9,000	8,000	38,000	2,000
Cumulative	40,000	4,000	12,000	21,000	30,000	38,000		40,000
Appropriations and expenditures:								
Total:								
In year		758	2,261	4,071	5,781	5,885	18,756	21,244
Cumulative	40,000	758	3,019	7,090	12,871	18,756		40,000
Detail by type:								
20 percent:								
20-yr maturities	8,000	25	115	205	295	385	1,025	6,975
15-yr maturities	8,000	33	146	266	386	500	1,331	6,669
15 percent:								
Supplemental grants	6,000	0	0	600	1,300	1,300	3,200	2,800
Year of obligation	6,000	700	1,200	1,400	1,400	1,300	6,000	0
30 percent: 2, 3, and 4 yr	12,000	0	800	1,600	2,400	2,400	7,200	4,800

Source: Housing Block Grant Feasibility Reports, February 1977.

APPENDIX

It was suggested in section V that a device other than contract authority might be used to take advantage of what was there called the double- or two-stage method of funding, avoiding the necessary for immediate appropriations to provide program authority, and thus

also avoid the accumulation of very large unexpended balances of appropriations.

One means of accomplishing this result would be through the use of an interim stage in which the authority would take the form of what might, for lack of a better name, be called a grant credit. Since this is not one of the standard forms of authority recognized in general law and practice, it would be advantageous for it to be a defined term in the authorizing statute. Thus, there might be included in the section dealing with definitions an item reading in substance as follows:

"The term 'established grant credit' means a credit established by the Secretary against available grant credit authority released in appropriation acts, in favor of a named eligible State or local body or grantee and in a specified amount."

The legal effect of grant credits would then be established by other language included at the appropriate point in the body of the text. Allowing for the absence of context, which likely would somewhat alter the form and wording, such a provision might read in substance thus:

"Upon receipt of notification by the Secretary of the establishment of a grant credit as herein provided, a State or other eligible grantee under this act is authorized to enter into contracts or other commitments to carry out programs eligible for housing block grants in amounts aggregating not to exceed the sum of the established grant credits made available from time to time to such State or other eligible grantee, plus any amounts allocated by the grantee to such programs which are derived from sources other than grants under this act."

Since we are dealing here with a somewhat novel device, it will probably make matters clearer to track through the legislative steps which would flow from the approach outlined above, with examples of the types of legislative or appropriation language which might serve at each stage.

The first necessity, of course, is to provide for the 5-year program authorization itself. This might be accomplished by a provision in the basic authorizing statute more or less as follows:

"The Secretary is authorized to establish grant credits in favor of States and other eligible grantees under this act in amounts aggregating not to exceed \$_____ after the effective date of this act plus additional amounts aggregating not to exceed \$_____ per year to become available on October 1 of each of the next succeeding 4 fiscal years: *Provided*, That no grant credits shall be established by the Secretary in excess of amounts approved from time to time in appropriations acts: *Provided further*, That amounts of grant credits approved in appropriations acts pursuant to this section shall constitute budget authority for the purposes of the Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-383)."

A provision such as the above would establish the 5-year program authorization. From this would flow, on the appropriate timing, three different forms of appropriation language: first, to provide the initial 3-year period of available budget authority proposed in section V; second, to provide annual increments to this initial funding for the fourth and subsequent years; and finally the actual appropriation for

making grant payments as funds are needed by the local bodies to meet expenses.

Examples of these three provisions are provided below:

(INITIAL (3-YEAR) APPROPRIATION ACT LANGUAGE (APPROVAL OF GRANT CREDIT AUTHORITY))

HOUSING BLOCK GRANTS

Grant Credits

Grant credits for housing block grants as authorized by section— of (*citation of enabling act*) may be established by the Secretary in amounts not to exceed in the aggregate \$(*3-year total*), of which \$——— shall become available on the enactment of this act; \$——— on October 1, 19—; and \$——— on October 1, 19—.

ANNUAL INCREMENTS IN SUBSEQUENT YEARS

HOUSING BLOCK GRANTS

In addition to amounts heretofore approved for grant credits for housing block grants to be established by the Secretary as authorized by section of ———, not to exceed \$——— in such credits may be established during the fiscal year 19—.

APPROPRIATIONS TO LIQUIDATE PRIOR AUTHORITY¹

HOUSING BLOCK GRANTS

For payments pursuant to established housing block grant credits as authorized by section — of ———, \$———, to remain available until expended.

The provision for this appropriation to remain available until expended is included simply to recognize the fact that the process of estimating future timing of transactions cannot be totally precise, so that payments estimated to occur in the fourth quarter of the fiscal year may well slip over into the following year. When this happens, it would be a needless nuisance if the funds were to lapse at the end of the fiscal year and have to be appropriated a second time. These carry-over amounts should not be large as a proportion of the appropriation, and should not need to be retained for extended periods after the end of the fiscal year. Nevertheless, the language seems justified as an avoidance of possible needless delay and added expense.

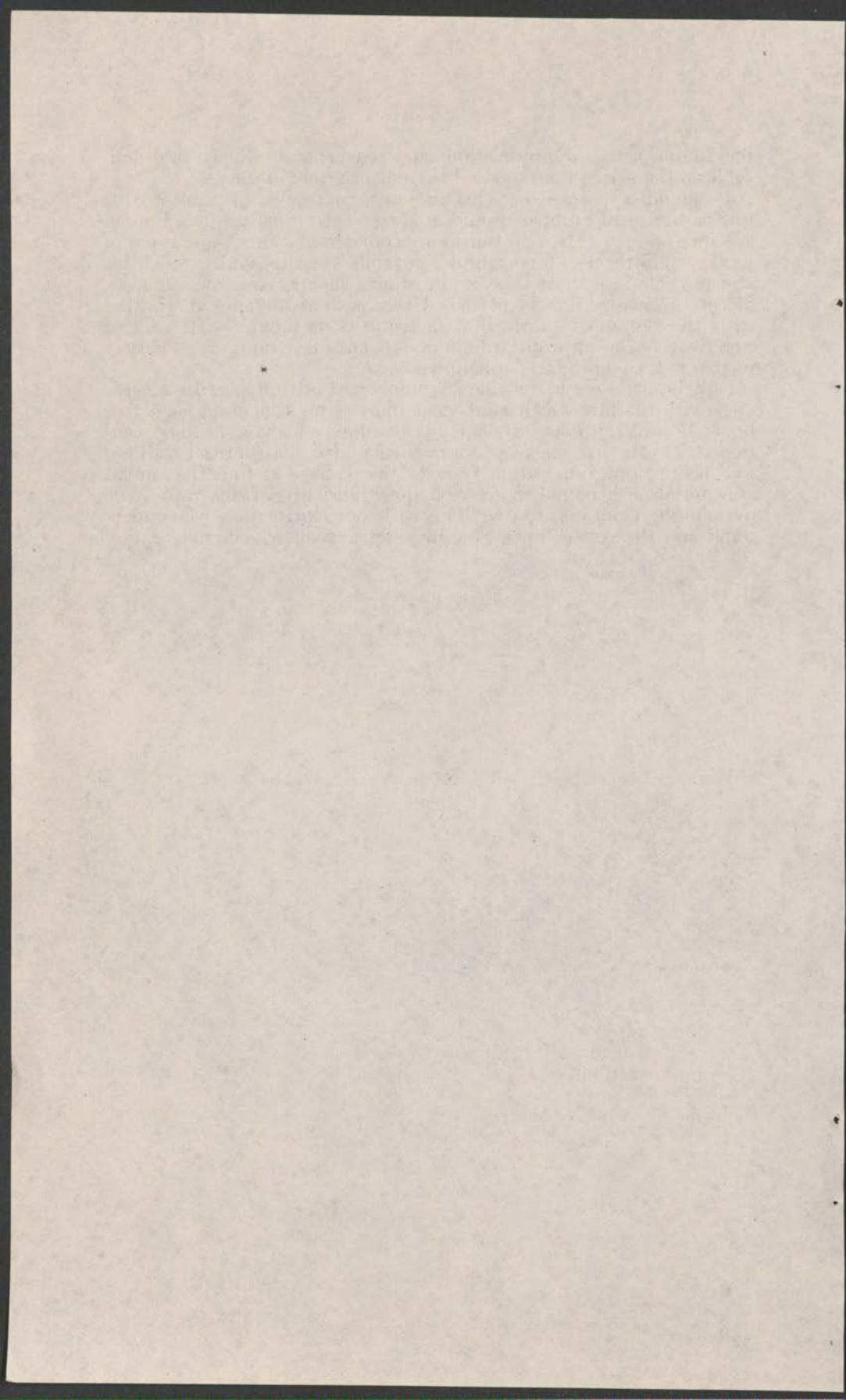
Thus we appear to have achieved a near-optimum approach to the funding elements described in section V: The approval of a 5-year program by the Congress in specified annual amounts, with authority to be made available through appropriation acts on any timing which the Congress may approve; 3-year funding through the use of budget authority which may be extended immediately to the States and local grantees without the interposition of a form of grant contract and without the necessity for immediate appropriations; and a system for

¹ Not budget authority, since the authority will have been enacted earlier.

fine-tuning actual appropriations and payments as closely as practicable to the need to meet actual current program expenses.

It should be pointed out that the initial extension of grant credits to State or local grantees would need to be accompanied by a limited advance of cash (from an initial appropriation), since some types of local commitments—for example, payrolls—mature and become due and payable in a short time, while others, such as construction costs, mature over much longer periods. Given such an advance of working cash, the system of quarterly cash requisitions should, with a bit of experience, keep appropriation and expenditure requirements closely related to actual program accomplishment.

Clearly, such a system offers a number of advantages. In accordance with the law which holds that there is no such thing as a free lunch, however, it does have one disadvantage which ought to be mentioned. This is that, since appropriations under this approach will lag well behind program authority, with the passage of time the annual appropriation is bound to give the appearance of growing rapidly or pyramiding from year to year. This will not surprise those who understand how the system works, but may alarm some who do not.



PROPOSED NEW TYPES OF HOME MORTGAGE INSTRUMENTS

(By Frank S. Kristof)

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SUMMARY AND CONCLUSIONS

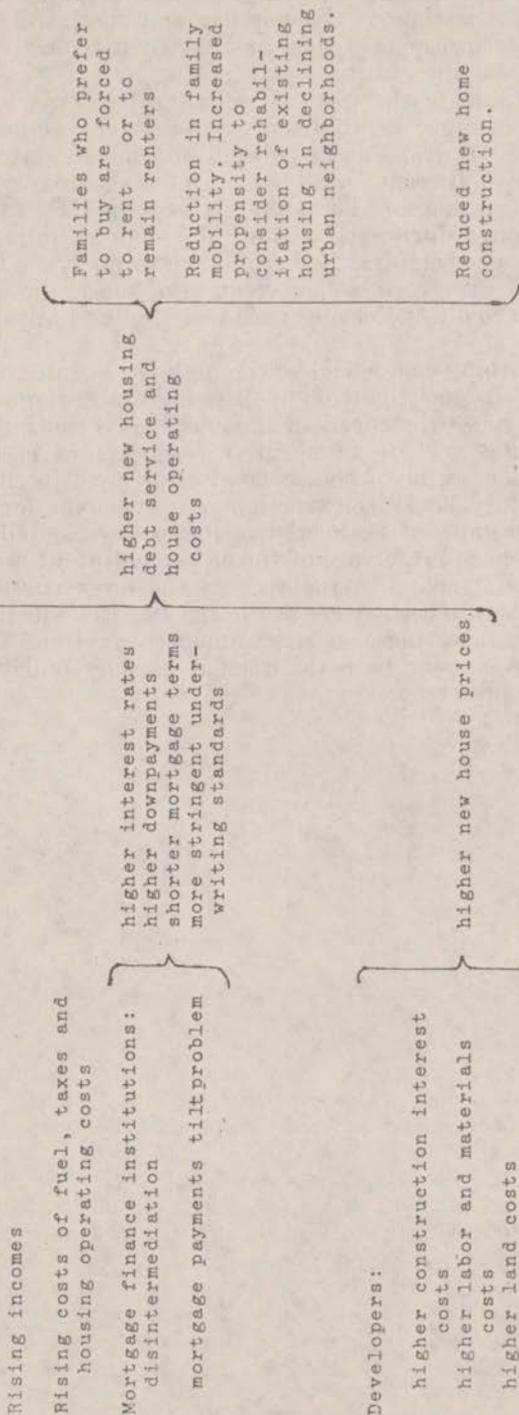
During the year 1976, discussion of the effects of inflation and high interest rates upon the production, financing and sale of new single-family homes was elevated to the level of serious discussion of new legislation. These entail proposals for the first basic changes in the

method of mortgage financing for single-family housing since the institutionalization of the popular and successful fully amortizing, level-debt-service mortgage in 1934 by the newly created Federal Housing Administration.

The villain in the piece is inflation, particularly inflation during a period of high unemployment and economic recession. These forces resulted in a drop of 26 percent in 1974-75 single-family housing starts and 42 percent for all housing starts compared with the previous 3-year performance. This was accompanied by substantial rises in interest rates during 1974 and 1975, some disintermediation during 1974 but a substantial turnaround of fund flows in 1975 and 1976, paralleled by record dollar volumes of mortgage closings caused in part by sharply increasing prices of single-family housing, new and existing.

A disturbing component of the high level of interest rates for home mortgages is that a portion of these high rates represents institutional efforts to offset the effects of the anticipated continuance of inflation. This creates a chain of negative consequences in the single-family construction sector of the economy illustrated in chart A. Moreover, single-family house construction is a synonym for homeownership, a basic premise of national housing policy as well as a clearly expressed tenure preference of the 65 percent of all households who are homeowners today. In the face of the large current surge of new households into the market at the age (25-29) when the shift to home ownership takes place in large numbers, anything that impedes this shift runs counter to both national housing policy and established consumer preference.

CHART A. ---CONDITIONS OF AN INFLATIONARY ECONOMY AND THEIR CONSEQUENCES UPON THE SINGLE-FAMILY HOUSING SECTOR



A complicated aspect of the inflation-high interest rate problem is that it affects adversely four major parties. The alleviation of the burdens on one of these four parties can adversely affect one or more of the other three. The four parties are three active ones and a residually affected one, namely:

1. Potential new home buyers who are now renters, owners of existing homes, or individuals (potential new households) living alone or with their families in owned or rented dwellings.

2. Mortgage finance institutions, predominantly savings and loan institutions and savings banks.

3. Housing developers.

4. The Nation's urban rental housing sector which is affected by any major change in rate of new single-family house construction in the suburbs (cf. pp. 9-11).

For example, any major drop in new single-family suburban construction may lead many potential buyers to consider the purchase and rehabilitation of existing vacant or under-utilized housing in urban areas.

Another example: The high interest rates set by mortgage lenders in anticipation of future inflation are essential to preserve them from financial injury through the disintermediation and mortgage payment tilt problems. These high interest rates also constitute, conversely, major components of high financing costs that force many potential buyers out of the home-buying market and contribute to developers' high construction finance costs and the higher prices of their new housing.

This same interest rate problem has caused many analysts to identify the long-term, fixed interest rate, level debt service mortgage as a "dodo" whose extinction is overdue in an inflationary environment. This "dodo" in fact turns out to be the lifeblood of the first home-buyer that produces the equity accumulation to make him a viable bidder for the larger and more expensive second home that families require as a consequence of increases in numbers and space requirements. The concentration of most of the proposals on lightening the early-year cost burden of first-time buyers in exchange for heavier later-year burdens when they ostensibly are better able to afford these higher costs simply creates new problems for these families as second-home buyers. With a minimal first-home equity buildup, the schedule of house prices they face for their second-home purchase is likely to be higher than the price they realize for their existing home. And in cases where the proposed legislation creates financial requirements that impose a potential loss on the borrower's first-home transaction, they may be immobilized with respect to the desire (or necessity) to move to another home.

In summation, any discussion of "new types" of mortgage lending instruments that does not entail outright subsidy simply is a discussion of how to shift costs back and forth among the participating parties or back and forth in time based upon theoretically valid generalizations that are of little condolence to the unfortunates who fall outside the range of probabilities or who are trapped by probabilities that do not eventuate. Any reallocation of costs among participating parties is likely to be a fruitless occupation considering that

all participants presently are injured in one way or another under inflationary conditions.

This brings the discussion to the fifth potential party in the cast of participants—the Federal Government—which inevitably becomes involved when the term “subsidy” appears on the scene. In the effort to ease the burdens of one or more of the participants in the train of causes and effects outlined in chart A, proposals invariably are made to distribute some of the costs to all income-earning members of society on grounds of an identifiable public benefit. Since the objective of home ownership is a recognized and accepted component of national housing policy, public subsidy consequently is a legitimate subject for consideration. In the context of the present discussion, several facts must be considered in weighing new subsidy proposals to encourage increased development of single-family home ownership:

1. Are the costs reasonable relative to the public benefits achieved?
2. Is there justification for new housing subsidies called for in proposals examined in the following pages given the fact that—

(a) In terms of housing quality, space and income-distribution, the most housing-needy portion of the American population is lodged in the rental housing sector;

(b) The great bulk of identifiable housing subsidies in America presently goes to home owners (income tax exemption for mortgage interest and real estate taxes);

(c) The sharp improvement in housing construction in 1976 occurred predominantly from the resurgence in single-family home starts; and

(d) There remains a substantial panoply of unaddressed problems of housing costs relative to incomes in the rental sector of the nation both in publicly assisted as well as unassisted private rental housing.

It is possible that public policy would be served by considering one or more of the home-ownership subsidies put forward for consideration, while simultaneously placing on the Congress' housing agenda the alleviation of problems in the rental housing sector of urban areas which includes a major proportion of the nation's housing-needy families.

In chart B, an assessment in summary form is presented for the five major proposals examined in this document. Although all five proposals are oriented particularly to the needs of the borrower, essentially to make it possible for modest-income, younger families to bid for new homes in the ownership market, three, the HUD graduated payment plan, the Ashley-Brock bill and the Brooke bill are rated poor in the achievement of this goal. In light of the fact that, on the average, home buyers find it necessary or convenient to sell their house within 7 years, in none of these three plans does the buyer acquire any equity to speak of during the first 10 years or longer. Consequently, whatever buyers will realize in the way of inflationary profits on the sale of their homes will be vitiated by the inflationary purchase price of the second home. If they do not realize gains to the same extent that new house prices have increased, they will be losers, and in little better position than they were 7 (or whatever) years earlier. In this latter situation, the proposal to sell may be inhibited and mobility is impeded.

Criteria	I	II	III	IV	V
<p>Problem addressed</p> <p>Low cost mortgage payments in early years. Higher market interest rate than in later years. Interest payments not tax deductible.</p>	<p>Low cost mortgage payments in early years. Higher market interest rate than in later years. Interest payments not tax deductible.</p>	<p>Monthly reduced mortgage payments in early years. Higher market interest rate than in later years. Interest payments not tax deductible.</p>	<p>Level debt service. Lower market interest rate than in later years. Interest payments not tax deductible.</p>	<p>Below market interest rate. Higher market interest rate than in later years. Interest payments not tax deductible.</p>	<p>Below market interest rate. Higher market interest rate than in later years. Interest payments not tax deductible.</p>
<p>Effect upon:</p> <p>Lender: Adverse</p> <p>Borrower: Adverse</p> <p>Federal government: Neutral to adverse</p>	<p>Mixed</p> <p>Adverse</p> <p>Adverse</p>	<p>Adverse</p> <p>Favorable on savings tax exemption</p> <p>Adverse</p>	<p>Neutral to favorable</p> <p>Favorable</p> <p>Neutral</p>	<p>Neutral</p> <p>Favorable</p> <p>Neutral</p>	<p>Neutral</p> <p>Favorable</p> <p>Neutral</p>
<p>Costs to:</p> <p>Society: None</p> <p>Gender: None</p> <p>Federal government: None</p>	<p>None</p> <p>None</p> <p>None</p>	<p>None</p> <p>None</p> <p>None</p>	<p>None</p> <p>None</p> <p>None</p>	<p>None</p> <p>None</p> <p>None</p>	<p>None</p> <p>None</p> <p>None</p>
<p>Effects upon:</p> <p>Inflation: Inflationary</p> <p>Income levels: Inflationary</p> <p>Real estate: Inflationary</p> <p>Real estate housing: Inflationary</p> <p>Real estate: Inflationary</p>	<p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p>	<p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p> <p>Inflationary</p>	<p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p>	<p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p>	<p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p> <p>Mildly deflationary</p>
<p>Interest Rates: Increases</p> <p>Income Levels: Increases</p> <p>Real Estate: Increases</p> <p>Real Estate Housing: Increases</p> <p>Real Estate: Increases</p>	<p>May increase demand by 5-10 percent.</p> <p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p>	<p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p>	<p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p>	<p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p>	<p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p> <p>Will increase demand, effect indeterminate.</p>
<p>Program Abuse: None</p> <p>Ability of Households: None</p>	<p>No major problems</p> <p>Regative impact</p>	<p>No major problems</p> <p>Regative impact</p>	<p>No major problems</p> <p>Regative impact</p>	<p>No major problems</p> <p>Regative impact</p>	<p>No major problems</p> <p>Regative impact</p>

Qualitative Data County for Federal Government.

The outright subsidy program proposals of Dade County and NAHB rate much higher on this count, and probably with much less ultimate cost than is entailed in either the Ashley-Brock or the Brooke bills with their complex methods of attempting to avoid subsidies but in turn creating inordinate dangers of default with all the losses these would incur for borrower, lender and the Government.

Only the Ashley-Brock bill approaches directly the lender's problem of distintermediation, a plus that is lost by the internal contradictions of seeking to shield the borrower from its costs.

It may be concluded that, on balance, the Dade County and NAHB proposals are well worth consideration if a simple method of widening the market for housing for lower-income families is deemed as a primary objective without addressing the problem of higher lender interest rates. The NAHB plan would have to be amended to incorporate income limits otherwise a lottery would have to be invented to ration a virtually unlimited demand for houses under this program. Even with income limits this plan undoubtedly would be popular.

In conclusion, there will be scope for considering the high lender interest rate problem in an analysis of the \$5 billion of variable interest loans made by six savings and loan institutions in California which initiated this type of loan in April 1975. There is unquestionably room for a broadening of the types of mortgage market instruments that should be available to different borrowers with different needs but the complexity and contradictions entailed in the three proposals graded "poor" indicates that more work needs to be done to achieve this end in satisfactory and workable forms.

PROPOSED NEW TYPES OF HOME MORTGAGE INSTRUMENTS

I. INTRODUCTION

The baby boom of the post-World War II years today is at the point where a recordbreaking cohort of 17.2 million persons born during the years 1947-51 has reached ages 25-29, an age group in which household heads make the shift from renter to single-family owner-occupancy in large numbers. Not only is this the largest number of persons in this critical age cohort relative to potential home ownership in the Nation's history, but it is a group whose numbers will continue to grow each year until it peaks out in 1987 and recedes thereafter (table 1).

TABLE 1.—NUMBER OF PERSONS REACHING AGE COHORT 25 TO 29, IN YEARS 1976-90

Year	Persons reaching age cohort 25 to 29	Year of birth	Age in 1970
1976	17,243	1947-51	19-23
1977	17,586	1948-52	18-22
1978	17,970	1949-53	17-21
1980	18,532	1950-54	16-20
1981	19,070	1951-55	15-19
1982	19,605	1952-56	14-18
1983	19,941	1953-57	13-17
1984	20,299	1954-58	12-16
1985	20,536	1955-59	11-15
1986	20,789	1956-60	10-14
1987	20,822	1957-61	9-13
1988	20,855	1958-62	8-12
1989	20,805	1959-63	7-11
1990	20,480	1960-64	6-10
	20,209	1961-65	5-9

Source: U.S. Bureau of the Census, "1970 Census of Population," vol. 1, pt. 1, table 50.

The significance of this 5-year cohort may be noted in table 2 by comparing it with its older 5-year cohorts that to a large extent already have become owner-occupants.

TABLE 2.—5-YR COHORTS BY YEAR OF BIRTH AND EXTENT OF OWNER-OCCUPANCY AMONG HUSBAND-WIFE HOUSEHOLDS: UNITED STATES, 1970

Year of birth	Age in 1970	Persons (thousands)	Households and owner-occupancy: 1970		
			Age of head	Number (thousands)	Percent owners
1946 to 1950	20-24	16,371	Under 25	3,081	26
1941 to 1945	25-29	13,477	25-34	9,129	57
1936 to 1940	30-34	11,430		35-44	9,251
1931 to 1935	35-39	11,107			
1925 to 1930	40-44	11,981			

Source: "1970 Census of Population," vol. 1, pt. 1; "1970 Census of Housing" HC(2) 1, table A-7.

Thus it is clear that for at least the next decade the market for home ownership is likely to remain strong. Consistent with the foregoing is the fact that household formation in the first 6 years of this decade has achieved new peaks, averaging nearly 1.6 million new households annually since 1970 compared with an average increase of one million annually during the 1960's.

During the 1950's, production of new single-family housing broke all previous records, averaging 1.2 million annually over the decade.¹ In the 1960's, production of single-family homes was overshadowed by the major surge of rental housing construction even though the former maintained a reasonably high pace of starts ranging from a low of 780,000 to a high of 1,021,000 units and averaging about 900,000 annually.² In the past 5 years, single-family home completions climbed toward the levels of the 1950's averaging nearly 1.1 million

¹ U.S. Bureau of the Census, *1960 Census of Housing, Components of Inventory Change*, HC(4), pt. 1A, No. 1, table 1.

² U.S. Bureau of the Census, *Construction Reports, Characteristics of New One-Family Homes: 1970*, C25-69-13, July 1970, table 3, p. 10.

completions in 1971-73, only falling to .9 million during the recession years 1974 and 1975.³

The dissonant note in this recovery was the sharp inflation in median sales price of homes completed between 1971 and 1976 which jumped 75 percent, from \$25,200 to \$44,100, or an annual rate of increase of 12 percent over these 5 years. This was twice the 6-percent annual rate of increase in the sales price of new homes sold during the years 1963-69 (from a median of \$18,000 to \$25,000). Punctuating this more modest rate of price increase was a 9-percent decrease from a median of \$25,600 to \$23,400 during the recession year 1970—the only year that a decrease occurred in the 14 years, 1963-76.

The rate of price increase in new single-family home outpaced increases in median income in each of the 5 years, 1971-75 (table 3). This probably will be true for 1976, which experienced an 11.7-percent increase in sales price over the first 10 months of the year, a figure not likely to be matched by change in median family incomes.

TABLE 3.—MEDIAN FAMILY INCOME AND MEDIAN SALES PRICE OF NEW 1-FAMILY HOUSES SOLD, UNITED STATES: 1971-75

	Median family income		Median sales price of new 1-family houses sold		
	Dollars	Percent change from preceding year	Dollars	Dollars	Percent
1971.....	\$10,285	4.2	\$25,200	\$1,800	7.1
1972.....	11,116	8.1	27,600	2,400	9.5
1973.....	21,051	8.4	32,500	4,900	17.8
1974.....	12,836	6.5	35,900	3,400	10.5
1975.....	13,719	6.9	39,300	4,400	9.5
1976.....	NA	44,100	4,800	12.2

Source: Incomes: U.S. Bureau of the Census, "CPS, P-60, No. 101", table 13, p. 24. Sales prices: U.S. Bureau of the Census, "Construction Reports, C25-75-13," table 18, p. 46; 3C5-76-10, table 5, for 1st 10 mo of 1976.

Such a trend, if it persists, creates problems for potential home buyers since, for the purpose of mortgage financing, institutional practice is to limit the price of a house to a ratio of 2 to 2½ times annual family income for most purchasers.⁴ Thus, if house prices continue to increase more rapidly than family incomes given the above price-income ratios, an increasingly greater proportion of potential home buyers will be priced out of the market. This tendency has occurred only since 1970 however, and it reflects a reversal of a relatively favorable median income to median new house price ratio achieved in 1970 after a decade in which family incomes consistently rose more rapidly than house prices (table 4). As the data indicate, this relationship has fluctuated within a fairly narrow range with the exception of the very favorable point reached in 1970.

³ U.S. Bureau of the Census, *Construction Reports, Characteristics of New Housing: 1975*, C25-75-13, November 1976, table 2, p. 5.

⁴ The amount of downpayment is the other important variable in determining this relationship.

TABLE 4.—ESTIMATES OF PROPORTION OF ALL FAMILIES THEORETICALLY ABLE TO PURCHASE NEW SINGLE-FAMILY MEDIAN PRICE HOMES AT A RATIO OF 2 OR 2½ TIMES ANNUAL FAMILY INCOME: UNITED STATES, 1950, 1960, 1970, AND 1974

	Median single-family sales price	Median family income	Required income of buyer at—				Percent of all families with incomes insufficient to purchase new median priced single-family homes at—
			2 times annual income	2½ times annual income	2 times annual income	2½ times annual income	
1950.....	\$9,000	\$3,319	\$4,500	\$3,600	170	155	
1960.....	16,500	5,620	8,250	6,600	74	61	
1970.....	23,400	9,867	11,700	9,360	57	47	
1974.....	35,900	12,836	17,950	14,360	17	17	

¹ Calculated from U.S. family income distribution for 1950, Statistical Abstract, 1973, p. 328.

² Calculated from U.S. family income distribution for 1960 Ibid.

³ Calculated from U.S. family income distribution for 1970, Ibid.

⁴ Calculated from CPS, Consumer Income, series P-60, No. 101, January 1976, table 10, p. 19.

Although the family income/house price relationships in the years 1971 to 1975 were atypical for the United States, they are characteristic of the inflation in these years. When accompanied by sharp increases in interest rates, constriction of available mortgage lending funds, and substantial disintermediation in savings banks and savings and loan institutions—principal sources of single-family mortgage loans—they inevitably must generate substantial disquiet among both mortgage lenders and borrowers. The construction industry also has been adversely affected by sharply increasing construction and financing costs and a resulting fall in demand. The inflationary forces in the economy further have raised maintenance and operating costs of housing while the 1973-74 Arab oil embargo brought fuel and utility costs to levels never previously experienced. The foregoing events have led to significant public policy efforts to cope with the persistence of inflationary forces even during the recent recession of 1973-75.

Conventional mortgage instruments in an inflationary economy

The present analysis focuses on one aspect of the many consequences of a sustained period of inflation—the apparent breakdown in effective functioning of conventional mortgage instruments successfully in use since the early 1930's. The backbone of this system is the fixed-interest-rate level-debt-service fully amortizing mortgage used in conjunction with FHA mortgage insurance created in 1934. The fully amortizing feature of this mortgage instrument was a major departure from the nonamortizing or partially amortizing mortgages predominantly in use previously and which became a major problem when the high rate of mortgage foreclosures undermined the financial structure of mortgage lending institutions during the depression of the 1930's. Over the past 10 years of inflationary economic conditions, despite three decades of successful use, the long-term, fixed-interest-rate mortgage has been variously identified as inappropriate, obsolete, and a danger to the financial stability or even the continued existence of mortgage-lending institutions.

The problem is traceable to both the long-term and the fixed-interest-rate characteristics of the mortgage loan made by financial institutions that must secure their loan funds from relatively short-term deposits. In periods of inflation, these institutions have difficulty in paying competitive rates for deposits because the bulk of their income is fixed by the long-term characteristic of their fixed-interest-rate mortgages. The result is either a dearth of loanable funds or higher cost funds obtained from the Federal home loan banks at current market rates. This means that interest rates on new mortgages will reflect both the cyclically high short-term interest rate and the lenders' estimate of the future rate of inflation. This in turn creates a problem for the younger first-time mortgagors who are at the lower end of their long-term income potential and who thus must strain their financial capacity to purchase a home at the required high interest rates. It is not uncommon for first-time homeowners to expend 30 to 35 percent of family income initially for housing operations when they would be unwilling to exceed 20 to 25 percent of income for gross rental expenditures.

It is this group that tends to drop out of the market for ownership housing when mortgage interest rates reach levels of 9 percent or more which in turn adversely affects new home sales and, finally, new home construction. The conclusion is that the conventional mortgage does not fit the needs of the lender or the borrower very well in an inflationary economy.⁵

Conventional mortgage instruments and the borrower

Before undertaking any discussion of the proposed modification of the present mortgage instrument it is useful to reflect upon the advantages it has had for the borrower, particularly in light of the strong consumer appeal that the single-family home has in the United States, and the key role the level-debt-service mortgage has played in shifting the Nation from 40-percent homeownership in 1940 to 67 percent in 1974.

1. *Equity accumulation.*—Homeownership represents the largest single investment and most significant source of equity accumulation of most families in the United States which in itself represents a strong motive for homeownership. The income tax advantages that accrue from interest and real estate tax deductions are an additional incentive that encourage this investment.

2. *Certainty.*—Its level debt aspect, that is the knowledge that mortgage payments are fixed, has a strong psychological-emotional appeal to persons who, as a family unit, are not prone to risk taking or uncertainty.

3. *Mortgage payment tilt.*—Another aspect of fixed monthly payments that appeals to mortgagors is that, even in an environment of little or no inflation, fixed monthly payments over time tend to represent a diminishing financial burden as family income increases over its life cycle. This condition tends to free more of rising family income for savings purposes or for discretionary spending. In the inflationary environment of the last 10 years, families who contracted for mortgages in pre-1965 years have realized significant windfall gains as

⁵ David L. Smith, *FHLBB Journal*, "Reforming the Mortgage Instrument," Map 1976, p. 2.

more rapidly rising dollar incomes paid off loans made at a time when the value of the dollar borrowed was considerably greater. The phenomenon of fixed payment loans being repaid with dollars of a constantly declining real value in periods of inflation, referred to as mortgage payment tilt, has created severe problems both for lending institutions who are the suppliers of the gains realized by borrowers under these conditions and for new borrowers who are faced with sharply rising interest rates as a consequence. "When inflation is anticipated, it tends to be anticipated in the current level of interest rates—the higher the rate of anticipated inflation the higher are interest rates."⁶ Interest rates are forced to levels higher than would be necessary under noninflationary conditions in order to overcome the problem of mortgage payment tilt. This confronts new borrowers with sharply higher interest rates and level debt service payments than would be required under conditions of no inflation or unanticipated inflation. The result is that a higher income is required to sustain the larger mortgage payments of a house at a given price with the result that the proportion of families with sufficient incomes to pass mortgage lending standards drops. Under these conditions the demand for new housing weakens, with a consequent decrease in housing starts.

In summation, as a result of lenders' efforts to negate the problem of mortgage payment tilt, the high level of payments required of modest-income borrowers compels the marginal buyer either to reduce his housing demand (a smaller house, lower-priced, fewer amenities, more modest neighborhood) or to drop out of the market for home ownership.

Housing tenure and national housing policy

The Nation's housing goals have been many times expressed in terms of a decent home and suitable living environment for every American family. The manner in which this goal is enforced to assist the less affluent sector of the population to share in its realization has not been discussed with respect to all its economic and social ramifications, particularly in terms of housing tenure. The United States is blessed with plentiful land resources relative to the size of its population. The population has ready access to these resources through the automobile and an excellent highway network. Since the end of World War II, those families who could afford to do so have demonstrated quite decisively their preference for homeownership, although abetted by many forms of public assistance which has not seriously been challenged—such as FHA and VA mortgage insurance or guarantees, and Federal income tax deductions for mortgage interest and real estate tax expenditures. The latter, perversely, convey regressive benefits—the higher the incomes of families, and the greater their interest and tax payments, the greater the actual and relative tax benefits to such families.

Simultaneously, the process of increasing home ownership has required spacial rearrangement of the population—its dispersion into lower density areas that over time have grown from merely bedroom

⁶ R. Edelstein, J. Guttentag, *Interest Rate Change Insurance and Related Proposals . . . To Meet the Needs of Home Buyers and Home Mortgage Lenders in an Inflationary Environment* (study for HUD, 1976, mimeographed), p. 2.

suburbs of cities to fully self-supporting low-density areas with the development of many small commercial and industrial nodes of their own which in turn leads to diminishing economic dependence on the central city.

If these trends were purely a reflection of consumer preference they would call for little comment. But they have been assisted by public policy and subsidies that have contributed to a number of undesirable results which by now are familiar topics of discussion. These include:

1. Loss of population and weakening of the economic base of older central cities; the increased concentration of the poor, the black, and the Spanish-speaking minorities in these cities with the resulting increased segregation of schools and neighborhoods.

2. Because the median income of minority families is about three-fifths of that of white families, the shift of the middle class from rental to owner-occupied housing that has been occurring in the United States is concentrated heavily among white middle-class families with the consequence that the racial and color composition of growing, new, decentralized areas has been overwhelmingly white and nonminority. Only in recent years has this tenure shift occurred among middle-class minority families in significant numbers.

3. The economic disparity between renter families and owners has been steadily widening over the past quarter century. Median incomes of renter families in the Nation has declined from 83 percent of median incomes of owner-occupant families in 1950 to 60 percent in 1974.

4. New programs for encouraging home ownership among families who presently are renters necessarily must drain off the upper economic strata of renter families. This has an adverse social and economic impact, particularly in cities where rental units constitute a significant portion of the housing market. It thus exacerbates the negative trends afflicting these urban areas.

5. Zoning policies that tend to bar the development of multifamily housing in areas that have been developed predominantly with single-family housing, although locally generated, raise questions about national public policy to encourage home ownership that fails to come to grips with local policies that artificially inhibit the development of rental housing where normal market forces would permit its development.

The foregoing are problems that have developed both incidental to and as a consequence of the enormous growth of homeownership in the Nation. Consequently, proposed public policies to provide new assistance to facilitate or further subsidize homeownership should be considered in terms of (a) their impact in furthering the undesirable trends noted above and (b) suggesting policies designed to mitigate these effects, such as programs to extend the benefits of homeownership to families whose levels of incomes do not now permit consideration of this obviously desirable form of tenure. Public programs to facilitate and financially assist the conversion of existing rental properties to cooperative or condominium ownership is another possible approach that conceptually has been in existence for a long time although effective tools have yet to be designed to accomplish this goal.

II. HUD GRADUATED MORTGAGE PAYMENT PLAN, EFFECTIVE NOV. 1976

Description.—The graduated mortgage payment plan (GMP) is a modification of the level payment mortgage. Essentially, it permits less than level debt service mortgage payments for the first 5 or 10 years (depending upon the schedule chosen) of a 30-year FHA-insured single-family (or condominium) mortgage. The last 20 (or 25) years consequently require a higher monthly payment than would be required under the level payment mortgage schedule in order to achieve full amortization of the mortgage (table 5).

Problem addressed.—The GMP addresses directly the difficulties created for borrowers in the form of steep interest rates and debt service requirements set up to meet lenders' mortgage payment tilt problem in an inflationary environment. As such, it is beneficial to marginal buyers, those who just fail to qualify for a mortgage loan or those who barely qualify but are hesitant to commit as much as the required 20 to 25 percent of family income to debt service even if this would be acceptable to the lender.

The scheme essentially seeks to alleviate the impact upon borrowers of lender steps to deal with the mortgage payment tilt problem by reducing the earlier year monthly payments about 17 percent below the required level debt service payment (under one option) and by gradually increasing payments over a period of 10 years to a figure 12 percent above the level debt service payment.

In the example shown in table 5, the GMP of \$223 falls \$299 short of meeting the interest requirements of the mortgage in the first year. This sum is added to the total mortgage with the result that the base for computing interest in the second year is \$35,299. With a GMP of \$230 per month, the interest shortfall is reduced to \$240 in the second year which also is added to the mortgage balance. As shown in the table, increments to the mortgage balance cease in the sixth year when the first contribution toward amortization is made. As an offset to the years that the mortgage balance is increasing, slightly larger down-payments may be required to insure that the outstanding balance does not exceed the maximum permissible mortgage limit.

TABLE 5.—ILLUSTRATIVE EXAMPLE OF PAYMENT SCHEDULES AND MORTGAGE BALANCES OVER FIRST 11 YEARS OF LEVEL DEBT PAYMENT AND GRADUATED MORTGAGE PAYMENTS FOR A \$35,000 LOAN AT 8½ PERCENT INTEREST WITH A TERM OF 30 YEARS

Year	Level payment loan		Graduated payment mortgage		Difference in monthly payment
	Mortgage balance	Monthly payment	Mortgage balance	Monthly payment	
1.....	\$35,000	\$269	\$35,000	\$223	-\$46
2.....	34,747	269	35,299	230	-39
3.....	34,473	269	35,539	237	-32
4.....	34,175	269	35,715	244	-25
5.....	33,852	269	35,823	251	-18
6.....	33,501	269	35,856	258	-11
7.....	33,121	269	35,808	266	-3
8.....	32,708	269	35,660	274	5
9.....	32,260	269	35,403	282	13
10.....	31,774	269	35,028	291	22
11 plus.....	31,247	269	34,513	300	31

Source: HUD News, No. 76-366, Oct. 7, 1976.

Income groups affected.—Families who purchase a \$38,000 FHA insured home with a \$3,000 downpayment and an 8½-percent, 30-year level-debt-service mortgage of \$35,000 would require an income ranging between \$16,700 and \$20,000 to maintain a ratio of housing cost to annual income of 30 to 25 percent. The ratio of house price to annual income in these cases ranges between 2.3 and 1.9, which falls within normal rule of thumb relationships for mortgage underwriting purposes.

If the graduated mortgage payment approach is used, the initial year monthly mortgage payment is reduced from \$269 to \$223 (table 5). This would permit families with incomes ranging from \$14,800 to \$17,800 to purchase the same price house with the same mortgage terms and ratios of housing cost to income. The reduction of \$1,900 to \$2,200 in required income would, however, increase ratio of house price to annual income to a range of 2.6 to 2.1—still within reasonable underwriting standards.

Overall, a relatively small number of potential home purchasers will be affected—on the order of less than 2 million renter families with an income range of \$14,000 to \$22,000 and whose head of household is below age 45. This group is in the top quartile of the Nation's renter households.

This proposal does not address the subject of inflationary interest rates; it represents an effort to adjust to them. To the extent that homeownership is an accepted goal of the Nation, the GMP will make a modest contribution toward this goal. It is a reasonably simple program to administer and should present no serious difficulties in implementation.

Costs, benefits, and risks.—The HUD announcement effectively summarizes this scheme as a method of permitting families to “convert their future earnings into present home purchasing power” or to use up some of the advantages of mortgage tilt to overcome the high debt-service charges created by inflation-hedging interest rates. The essential assumption underlying such a payment schedule is that the family's income is upwardly mobile.

On balance, the benefits, to the extent they exist, accrue principally to the homebuyer. Some potential buyers will not recognize GMP as a benefit in terms of the higher level of debt service payments at the end of 5 or 10 years. This will be true of the most conservatively inclined families or of those whose outlook for the future is neither clear nor overly optimistic.

Although the costs of GMP will be borne eventually by the homebuyer, both the Federal Government and lenders make a substantial up-front contribution. The Federal Government's contribution comes in the form of heightened default risk in insuring 90- or 95-percent mortgages whose face value may not be reduced until the 11th year (table 5), which makes the debt-service payments virtually equivalent to rent for the first 10 years of this sales transaction. The risk of mortgage default upon such mortgages becomes substantially greater among financially more marginal families who experience even short-term economic difficulties. Given a mortgage payment schedule that will increase annually each year for the first 5 or 10 years of the mortgage term, and with no equity build-up as a motivation to forestall mortgage default, the probability of a higher default rate for this type

of mortgage is great. Finally, the lack of equity buildup in the early years leaves the mortgagor totally dependent upon inflationary value gains of his house to match those of house prices in general, should it become necessary to sell his home and to purchase another during this period. A substantial portion or all of his profit on sale may be nullified by the comparably higher prices he faces as a buyer.

From the lender's viewpoint, the prospect of a 30-year mortgage with no amortization within the first 10 years is not attractive financially. The present value of the first 11 years' stream of payments in the example in table 5 (discounted at 6.5 percent) is \$1,300 less than that of equivalent level-debt-service payment. In addition, the lender not only extends a loan whose amortization does not begin for 10 years but whose face value exceeds \$35,000 (up to \$35,856) for this entire period. On balance, it is not likely that lenders will view this program favorably except in instances where they temporarily are burdened with an excess of loanable funds that they are having difficulty in placing. This is not much of a foundation upon which to rest a new type of debt-service schedule represented by GMP. On balance, the GMP program could be helpful to potential homeowners who are at the margin of ability to purchase a home, who wish to do so, and whose income prospects appear to be reasonably bright.

Nothing in this mortgage payment schedule addresses the basic problem of lending institutions' mismatch of long-term mortgages financed by short-term borrowings. In fact, the modification of the payment schedule is such that it partially vitiates institutional attempts to deal with the problem of mortgage payments tilt under inflationary conditions without in any way addressing the question of what happens if the rate of inflation exceeds that anticipated by the interest rate set for the mortgage. In such case, GMP becomes even more of a disaster than the equivalent level debt service payment schedule. In order to reduce the risk of mortgage defaults which are most likely to occur in the early years when the mortgage balance is increasing under the GMP plan, lenders may react by increasing the interest rate or by tightening underwriting standards, increasing downpayment requirements, and limiting application of GMP loans to properties in locations where the probabilities of price appreciation are strongest—a procedure which raises the spectre of redlining all over again.⁷ In terms of broadening the market for marginal buyers, such a reaction by lenders would defeat the purpose of this approach. This discussion may be concluded by citing a lender's analysis of the proposal which tends to support the above observations. The GMP—

"Explicitly considers the borrowers future income potential via the graduation rate . . . If the borrower's income increases at least as rapidly as the graduation rate and the value of the property increases in excess of negative amortization, there will be little chance of default. Risks are incurred by the lender when either of these two events do not occur. Careful analysis of both the borrower's potential income growth and the future stability of the property should eliminate these."⁸

⁷ Cf. Donald M. Kaplan, *FHLBB Journal*, "The Alternative Mortgage Instruments Research Study," October 1976, p. 12.

⁸ David L. Smith, *Alternative Mortgage Instruments*, paper submitted to the National Savings and Loan Committee on Alternative Instruments (mimeo), September 1976, p. 2.

III. The Ashley-Brock Bill, S. 3193, March 23, 1976 As Amended September 24, 1976 Description.—The Ashley-Brock bill has four major lines of approach:

1. It provides to the borrower a fixed-rate loan 2 percent below the contract rate of the mortgage for the first 10 years of the mortgage term.

2. For the lender it encompasses the principle of a variable interest rate mortgage keyed to the 3- to 5-year bond yields of U.S. Government bond issues but no more than 2½ points above the initial lending rate.

3. GNMA, with appropriations authorized up to \$1 billion, is directed to make "housing incentive investment interest payments to lenders with respect to mortgages . . . approved" under this act which remits to lenders the difference between a variable lender's interest rate (adjusted by not more than one-fourth of 1 percent each 6 months) and the interest rate paid by the borrower which initially is 2 percentage points less than the contract rate at the date of execution of the mortgage. The lender's interest rate is established by "the medium-term bond yield as reflected in the index of the average of 3- to 5-year U.S. Government bonds and the rate on seasoned corporate bonds." The 6-month adjustments in interest rate will be determined by the same index.

4. The cumulative GNMA interest differential payments (without interest) become an obligation of the borrower to be repaid (a) at the time of disposition of the house, (b) at the end of 10 years, or (c) amortized under mortgage refinancing provisions at the end of 10 years.

Other relevant provisions of the bill that are of policy significance are:

(A) Whereas the original draft of the bill was limited to homes with a mortgage loan not in excess of \$35,000, its amended form removed the restriction on mortgage amount and substituted a family income limit "not to exceed by more than 40 percent the most recent U.S. Census Bureau figure for median family income in the United States" (a ceiling of \$19,200 in 1975). Families with 1975 incomes of \$19,000 or less encompassed about 70 percent of the Nation's total families. On the other hand, the figure includes about 93 percent of all renter families with a household head under age 45, which covers a reasonably complete potential of this market for home-ownership.

(B) The original draft required that interest be paid by the borrower on GNMA payments under this act at the interest cost of these funds to the Government. This provision was eliminated in the revised draft.

(C) The original draft of the bill appeared to permit the GNMA interest differential payments to continue for the life of the mortgage. This provision was scaled down to a life of 10 years in the amended draft.

(D) Mobile homes were included within the scope of the bill in its amended form.

Problems addressed.—The bill represents an ambitious attempt to solve simultaneously major mortgage financing problems of both borrowers and lenders in an inflationary environment. These are,

namely: 1. The problem of high interest rates set on mortgages to discount the effect of inflation which results in high debt-service requirements coupled with lower loan to value ratios (high down-payment requirements) and increases family incomes required to purchase a house of given price. The provision of a mortgage interest rate 2 percentage points below the contract rate for 10 years will enable families to purchase homes with incomes about one-fifth lower than otherwise would be required—\$14,500 instead of \$18,000 for the purchase of a \$40,000 house. This provision effectively gives the borrower a reduced-rate level-debt-service mortgage for the first 10 years of the mortgage term.

2. Two lender's problems: (1) the necessity to set excessively high interest rates to eliminate losses to the lender arising from the liquidation of long-term debt with constant payments of diminishing real value because of inflation and (2) the dangers of disintermediation. Both of these problems are addressed by use of the principle of "the variable mortgage interest rate" sustained by GNMA payments during the first 10 years and by the borrower thereafter.

The tools created to meet these objectives thus are designed to ameliorate the deleterious effects on lenders caused by the fixed terms of existing mortgage loans in periods of inflation and averting a substantial reduction in number of eligible borrowers as a result of interest rate increases on new loans in the effort to discount the effects of anticipated inflation.

Costs

Any effort to deal with the effects of inflation upon both lenders and borrowers simultaneously generates costs for someone. In this case, costs will be borne by three parties:

1. *The borrower.*—In much the same manner as was outlined in the GMP system, the borrower effectively mortgages the future benefits of his anticipated rising life-cycle income for the present benefit of being enabled to purchase a home he could not afford under the conventional level-payment mortgage whose terms have been adjusted for anticipated inflation. Despite the postponement for 10 years (in the form of a second mortgage obligation to FNMA) of all costs between 2 percentage points below the lenders initial interest rate plus incremental charges to adjust for inflation semiannually up to a maximum of $2\frac{1}{2}$ percentage points above the initial rate, the cumulative effect of this second mortgage loan (even without interest) conceivably could exceed the increase in value of the home and leave the borrower with the prospect of financial loss when he wishes to sell his house.

A psychological as well as eventual dollar cost to the borrower is the knowledge that, at the end of 10 years, his aggregate mortgage debt will be greater than it was at the date of purchase—table 6. Aside from his tax benefits, this borrower effectively has been a renter except that he has the—not certain—benefit of being able to realize the inflationary gains in the value of the house at any time he chooses to sell during the first 10 years. To what extent these gains will exceed the increase in the owner's mortgage liability depends upon the relative status of his neighborhood, the rate of inflation, local housing and mortgage market conditions at the time the house is placed upon

the market, together with the financial ability of the owner to wait out any temporary market weaknesses—the duration of which is unpredictable—at the time a sales decision is made. To the extent that the sales price fails to cover both the first and second—GNMA—mortgage liability the purchaser is left with a net loss to be made up in future payments.

TABLE 6.—HYPOTHETICAL EXAMPLE OF THE FINANCIAL ARITHMETIC WITH THE HOUSING INCENTIVE INVESTMENT INTEREST PAYMENTS PROGRAM, S. 3193

Year and month	Mortgage balance beginning of period	Remaining years of mortgage term	Interest rate		Annual debt service			GNMA incentive investment interest payment
			Lender	Borrower	Lender's		Borrower's amount	
					Rate	Amount		
1: 0.....	\$36,000	30	8.0	6	0.08806	\$3,170	\$2,590	\$580
6.....			8.0	6				
2: 0.....	35,710	29	8.25	6	.0909	3,246	2,590	656
6.....			8.25	6				
3: 0.....	35,410	28	8.5	6	.0938	3,322	2,590	732
6.....			8.5	6				
4: 0.....	35,098	27	8.75	6	.0967	3,394	2,590	804
6.....			8.75	6				
5: 0.....	34,775	26	9.0	6	.0997	3,467	2,590	877
6.....			9.0	6				
6: 0.....	34,438	25	9.25	6	.1028	3,540	2,590	950
6.....			9.25	6				
7: 0.....	34,084	24	9.5	6	.1060	3,613	2,590	1,023
6.....			9.5	6				
8: 0.....	33,794	23	9.75	6	.1093	3,694	2,590	1,104
6.....			9.75	6				
9: 0.....	33,395	22	9.5	6	.1086	3,627	2,590	1,037
6.....			9.5	6				
10: 0.....	32,941	21	9.25	6	.1082	3,564	2,590	974
6.....			9.25	6				
11: 0.....	32,424	20	9.0	9	.1080	4,445	4,445	
Aggregate obligation to GNMA ¹	8,737							8,737
Total.....	41,161							

¹ Interest costs to GNMA of these payments (at 6½ percent per annum) aggregate approximately \$3,250 which bring the runout costs for this 10-year program to about \$12,000, of which \$8,737 eventually may be recaptured, barring defaults

The amended version of the bill places upon the borrower the requirement, at the end of 10 years—if the house has not been sold—to “satisfy his obligation under the first and second mortgage without a prepayment penalty or to refinance and amortize the accumulated advances . . . at the lenders’ interest rate.” This provision of the bill suggests that if, at the end of 10 years, the borrower has not sold his home at sufficient profit to repay all his accumulated obligations to GNMA—or suffers a loss if the proceeds are insufficient to liquidate both the first and second mortgage—he must take steps to jump his payments in order to begin amortization of the refinanced mortgage which encompasses his accumulated financial obligation to GNMA.

In table 6, a hypothetical example of a \$44,000 house financed with an 80-percent mortgage of \$36,000—or a \$40,000 house with a 90-

percent mortgage of the same amount—is shown with the GNMA incentive investment payments run out for the 10 year limit under the amended terms of S. 3193. The example starts with a hypothetical interest rate of 8 percent and assumes an average of 9 percent for the lender's variable interest rate over the 10 years, contrasted with the 6-percent rate chosen by the borrower. The latter rate entails a monthly debt service payment of \$216 per month and an overall housing operating expense of about \$375 per month which could reasonably be afforded by an \$18,000 family at a 25-percent gross housing expense to gross income ratio. This income is well within the maximum of \$19,200 permitted under the bill at 1.4 times the most recent—1975—national median income: \$13,719. (See table 3).

Even under the relatively modest inflationary conditions that this example projects over the next 10 years, the aggregate mortgage liability of the borrower will have increased to more than \$41,000 at the end of 10 years. In the 11th year, the monthly debt service to liquidate the remainder of the original mortgage plus GNMA incentive investment payments aggregating \$8,700, over the 20-year remaining life of the mortgage term, jumps to \$370, a 71-percent jump from the 10th year figure of \$216. Assuming operating cost increases of 6 percent annually, this would mean a monthly house operating expense of \$650 per month compared with a figure of \$480 experienced during the 10th year.

This new housing expense level requires that the owner's income should have increased by 73 percent—to \$31,200—in order to maintain the identical gross housing expense to gross income ratio assumed by this family 10 years earlier. Of course, if this rate of income increase is achieved—an annual rate of plus 5.6 percent—it may be observed that the gross housing expense to gross income ratio would have decreased from 25 percent to 18 percent between year 1 and year 10, returning to 25 percent in the 11th year.

The question whether the substantial 11th-year increase in debt service can readily be supported is dependent heavily upon the rate of increase in the borrower's income. Limited experience with sharp jumps in housing cost requirements indicates that they are not readily tolerated either financially or politically by borrowers whose financial status has not improved to the extent necessary to absorb these costs—particularly when such discontinuities arise from statutory requirements that are amenable to amendment.

2. *The lender.*—Unless this system is coupled with mortgage insurance, it represents a higher-than-average-risk loan, given the uncertainties posited above. A serious or even temporary economic reversal to the borrower family creates greater than normal mortgage default risks during the period when the equity position of the purchaser is deteriorating as it does by definition over the first 10 years of this scheme. The second major default risk to lenders arises at the end of the 10th year as discussed above.

3. *The Federal Government.*—The manner in which this legislation is structured suggests that the Federal Government is likely, inadvertently, to shoulder major costs of this program. These costs will arise from the following sources:

1. Since no provision is made for payment of interest on the housing incentive investment interest payments, this becomes a silent

subsidy component of the program, which, once these payments reach the level of a billion dollars, will constitute an interest forgiveness of \$65 million annually—at a 6½ percent borrowing rate to GNMA—so long as this sum is outstanding.

2. To the extent that these mortgages are insured, and defaults—discussed above—occur beyond the ability of insurance premium reserves to absorb such losses, this will become a public charge.

It should be noted that 10 years of housing incentive investment interest payments at an average mortgage amount of \$40,000 per house and an average difference of 3 percent between the lender's and the borrower's interest rate will have a runout cost of \$12,000 per unit—including the interest costs incurred by GNMA; see table 6. Thus the \$1 billion limit placed upon these payments will permit about 83,000 home purchases to be financed under this program, a number that constitutes less than a tenth of a normal year's single-family home construction.

Economic premises of the program and its effects upon:

1. *Inflation.*—The Ashley-Brock bill does not directly address the subject of inflation; rather, it accepts inflation as a fact of life to which adjustments realistically must be made. This mortgage lending program proposes to utilize some of the effects of inflation (the continued rise in incomes and house prices) to offset its negative effects upon housing sales and construction caused by the high interest rates set by mortgage lending institutions to offset anticipated inflation. Under this legislation anticipated income increases of the borrower family are essential to successful amortization of its mortgage terms. If inflationary rises in incomes are slowed, or individual circumstances do not result in continually rising incomes, the program will entail an increased rate of mortgage defaults. To the extent that programs such as these contribute to pressures for continued increases in family incomes irrespective of basic economic conditions, the inflationary forces of the economy will be strengthened. On the other hand, as later noted, if the program were to become a substantial component of total new mortgage loans, it would tend to reduce upward inflationary pressures on interest rates.

2. *Income levels served.*—This program would service a reasonably broad segment of renter households with annual incomes ranging from \$14,000 to \$19,000 who could undertake new home mortgages ranging from \$25,000 to \$40,000. There were slightly over 2 million renter households in this income range in 1975, only about half of whom had heads below age 45.

An additional 2 million rental families in the income range \$12,000 to \$14,000 could be in the market for existing homes since these have lower selling prices than new homes. On the other hand, the proportion of these families who would not be likely to pass underwriting tests probably would appreciably diminish the potential number of eligible applicants. Mortgage risks for such families would be greater since the prospects of continued price increases for homes in older neighborhoods generally is weaker than those for houses in newer neighborhoods, while the prospects for continued income rises at this lower income level may be less assured.

3. *National housing goals.*—The immediate effect of this program would be to widen opportunities for home ownership. To the extent that it attracts marginal rental families whose prospects for continued increases in annual income are below average, the program could have negative effects on their well-being. A mortgage debt service schedule that calls for a major jump in payments after the 10th year is alien to the average family, and the lower down the income ladder that such a requirement is enforced, the more frequent will be the occurrence of families whose continued rise in incomes is subject to interruption and consequent financial distress.

4. *Interest rates.*—The effects of this program on interest rates will tend to be beneficial by removing the pressures for increases in interest rates to offset anticipated inflation. Interest rates would change (semi-annually) on the basis of normal market conditions that determine interest rates of 3-5 year U.S. bonds and seasoned corporate bonds. The latter also will reflect inflationary expectations but not to the same extent as that required for 30-year mortgages. In order for this type of mortgage to constitute a significant proportion of total new mortgage obligations, however, an enormous increase would be required in GNMA authorizations to make incentive investment interest payments.

Given the earlier indicated run-out costs of the GNMA incentive interest payments of \$12,000 per unit, it would require an authorization of \$1.25 billion annually to GNMA to permit this program to provide incentive interest payments for 100,000 home purchasers each year. Calculated in terms of 1976 costs and an interest rate of 9 percent as the average variable interest rate of lenders, a run-out calculation indicates that the outlays of GNMA, including interest costs, would average \$630 million annually or an aggregate of \$12.6 billion over 20 years if an 100,000 additional homes were assisted with payments each year. Annual outlays begin at \$124 million in the first year and reach a peak of \$1.84 billion in the 10th year by which time one million families are receiving payments. Aggregate outlays decline thereafter, to \$1.33 billion by the 20th year when 2 million homes are in the program. It becomes self-sustaining in the 30th year (3 million homes) and produces a surplus thereafter.⁹

In order to significantly mitigate the effects of inflation on mortgage interest rates, it has been suggested that GNMA incentive interest payments would need to be available to at least half of the new home buyers annually (400,000 to 500,000). This, however, would require scrapping of the concept that the program be restricted to first-time purchasers, and it would make the impact of GNMA borrowings on the capital markets sufficient to raise problems about diversion of capital funds from other uses.

5. *Mortgage lending institutions.*—Lending institutions will be a major beneficiary of variable interest rates if such mortgages are insured to immunize lenders against the higher risks marginal buyers may incur. Without insurance, this system would be subject to more stringent underwriting standards which, of course, would be self-defeating in terms of its negative effect upon the effort to expand the market for home ownership.

⁹ The calculations do not include prepayments which would reduce per unit costs.

6. *Administration.*—Although somewhat complex relative to level debt service mortgages, the variable interest rate aspect of these mortgages should be reasonably easy to administer since the adjustments will be required only twice a year and should be relatively easy to program. GNMA administrative costs would be substantial.

7. *Program abuse.*—The major element of potential abuse that could occur in the administration of this program would be the problem created by applicants whose prospects for income increase clearly are marginal. Although this is a normal underwriting obligation of the lender, it is a problem that cuts two ways: An excessive rejection rate vitiates the intent of the program to broaden the market, while lax underwriting standards will result in excessive mortgage defaults.

8. *Mobility of households.*—Implicit in much of the foregoing discussion is the suggestion that mortgage schemes that lock purchaser families into a negative equity position in the early stages and, in some cases, even in the later stages of the mortgage term will have an inhibiting effect on family mobility when it becomes necessary to move, for example, for employment reasons. When this occurs in combination with a failure of the value of a home to increase more rapidly than the mortgage debt, a family faces the problem of being "locked in" until the market, or its equity position, improves or of becoming a "walk-away," either of which has adverse impact on mobility in terms of ability to purchase another home. This is a characteristic that is inseparable from any decision that results in "mortgaging" future income increases for the ability to purchase a home at a time when it otherwise would not be possible.

Particularly relevant to this discussion is that owners tend to move, on the average, once each 7 years. Families in occupancy during the first 10 years not only will face the prospect of minimal gains on the sale of their home during this period but they will face difficult prospects in becoming second-home purchasers to the extent their first house sales transaction turns out to yield no (or a minimum) cash return usable for the downpayment on the purchase of a second home. In a significant sense, it is possible that large-scale success of this program could create a new set of problems for these families as second home purchasers, all of which definitely will have an adverse effect upon family mobility.

IV. THE BROOKE BILL—YOUNG FAMILIES HOUSING ACT OF 1976, S. 3692

Description

This bill contains two major components. First, is the equity-adjusted insured-mortgage provision which provides FHA insurance for 90-percent, 30-year mortgages under section 203(b) at a fixed interest rate but which contains a provision for an annual (downward) adjustment of the nominal mortgage payment based upon half the average annual rate of inflation over the previous 3 years as measured by the BLS consumer price index.¹⁰ The equity adjustment reduces the mortgage payment burden on borrowers over the life of the mortgage so long as the 3-year average of the BLS CPI continues

¹⁰ If inflation were to be reversed, the adjustment to the mortgage payment would be upward.

upward. As the HUD simulation model (table 7) shows, however, the cumulative additions to the mortgage principal ensuing from the annual reductions in actual payments caused by the inflation adjustments, forces the basic payment requirements to such high levels that the inflation adjustments succeed only in slowing the rate of increase in actual payments over the last half of the mortgage term. Beginning in the 14th year, annual payments consistently increase over the initial basic payment requirement without interruption to the 29th year.

TABLE 7.—EQUITY ADJUSTED MORTGAGE SIMULATION

(Principal plus \$30,000; interest rate is initially 5.900)

Year	Basic payment	Actual payment	Adjustment 1	Inflation factor	Adjustment 2	Average mortgage rate	Principal balance	Net loan yield
1966	176.16	158.86	17.30	1.38	1.16	5.81	30,000	5.9000
1967	177.93	153.53	24.41	1.96	1.77	6.46	29,813	5.8994
1968	180.16	149.82	30.34	2.45	2.23	6.46	29,680	5.9048
1969	183.42	142.41	41.01	3.33	3.26	7.22	29,588	5.9113
1970	187.80	136.92	50.88	4.13	4.39	8.08	29,585	5.9324
1971	193.55	129.60	63.94	5.17	5.74	8.47	29,659	5.9755
1972	199.12	134.64	64.49	5.19	5.58	7.77	29,842	6.0381
1973	203.99	147.83	56.17	4.50	4.87	7.61	29,990	6.0813
1974	209.26	152.00	57.27	4.58	5.27	8.20	29,995	6.1144
1975	217.80	132.32	85.47	6.85	8.53	9.18	29,961	6.1605
1976	228.91	118.08	110.82	8.81	11.11	8.96	30,188	6.2598
1977	240.41	128.23	112.17	8.79	11.50	9.00	30,637	6.3726
1978	250.03	158.15	91.89	7.11	9.63	9.00	31,021	6.4820
1979	258.43	180.21	78.22	6.04	8.40	9.00	31,091	6.5672
1980	266.96	189.67	77.29	6.00	8.53	9.00	30,915	6.6374
1981	275.68	199.10	76.58	6.00	8.72	9.00	30,632	6.7050
1982	284.59	209.00	75.58	6.00	8.91	9.00	30,233	6.7705
1983	293.68	219.43	74.26	6.00	9.10	9.00	29,704	6.8341
1984	302.98	230.41	72.57	6.00	9.30	9.00	29,027	6.8957
1985	312.48	242.02	70.46	6.00	9.50	9.00	28,185	6.9554
1986	322.19	254.30	67.89	6.00	9.71	9.00	27,156	7.0133
1987	332.10	267.30	64.80	6.00	9.92	9.00	25,919	7.0694
1988	342.23	281.12	61.12	6.00	10.13	9.00	24,447	7.1238
1989	352.58	295.80	56.78	6.00	10.35	9.00	22,712	7.1765
1990	363.16	311.45	51.70	6.00	10.57	9.00	20,681	7.2276
1991	373.96	328.16	45.80	6.00	10.80	9.00	18,320	7.2772
1992	385.00	346.02	38.97	6.00	11.04	9.00	15,589	7.3253
1993	396.27	365.16	31.11	6.00	11.28	9.00	12,444	7.3720
1994	407.79	385.70	22.09	6.00	11.52	9.00	8,885	7.4173
1995	407.79	407.79	-0	-0	-0	-0	4,707	7.4612

Source: Hearings, Senate Subcommittee on Housing and Urban Affairs, 94th Cong., Aug. 4, 9, and 10, 1976, statement of John C. Weicher, p. 119.

The basic premise of tying changes in mortgage payments to one-half the rate of inflation is that the nominal value of the house at the minimum will increase at least at half the rate of inflation. Effectively, the borrower is being permitted to realize the inflationary increment in value of his house (without having to sell it) through provision for an automatic loan from the lender, which creates the deficit in the nominal mortgage payment caused. The borrower is required to liquidate this series of loans over the remaining balance of the mortgage term shown by the constantly rising actual payments.

The borrower at any time may choose to cease accepting downward inflationary adjustments which will tend to flatten the payments schedule at whatever basic payment level it has reached when this decision is exercised. The manner in which the formula works, however, permits these payments to follow a graduated upward curve rather than experience the sudden jump in debt service required in the 11th year under the terms of S. 3193 (the Ashley-Brock bill).

The second major component of S. 3692 is the "Individual Housing Account" which allows as a deduction from Federal income taxes "amounts paid in cash during the taxable year by such individual to an individual housing account." The maximum amount allowable for such an account is \$2,500 annually up to a maximum of \$10,000. The account must be held in trust for no longer than 10 years and when distributed, must be used "exclusively in connection with the purchase of a principal residence . . ." otherwise such distribution becomes taxable.

Problems addressed.

This bill provides a unique approach to the needs of prospective modest-income home purchasers who otherwise would be impeded from entering the sales market by high mortgage costs. It provides for reductions in early-year mortgage payments on the premise that the value of a purchased house will increase at half the average rate of inflation over the previous 3 years. The mortgagor is permitted to realize this assumed increase in value through a reduction in mortgage payments in the form of an interest-bearing forced loan from the mortgage which is added to the mortgage balance, to be liquidated over the remaining life of the mortgage. The price for these mortgage payment adjustments accordingly becomes higher payments in later years on the principle, not unlike that of the Ashley-Brock bill, that increases in the family income stream over time will permit later high payments to liquidate the additional "second mortgage" borrowings of the early years. Not addressed is the problem of extra-high mortgage interest rates used by lenders to offset anticipated inflation. This latter phenomenon simply is finessed by the "inflation adjustments" for the borrowers, leaving to lenders the option of setting whatever initial interest rate is deemed necessary in the face of anticipated inflation.

The bill meets what is deemed another major problem, not considered by any of the previously discussed programs, that of encouraging savings by prospective home buyers to meet current mortgage market requirements for high downpayments on new houses. The mechanism used is that of tax incentives. Up to \$10,000 of savings in approved "individual housing accounts", limited to a maximum of \$2,500 annually, would be exempt from Federal income taxes provided they eventually are used for approved housing purchase purposes.

Costs.

The various costs associated with the benefits of the Brooke bill are apportioned among all three participants in the proposed program: the borrower, the lender and the Federal Government.

1. *The borrower.*—The annual mortgage payment adjustments (reductions) permitted as a consequence of continued inflation over the 3 years immediately prior to the year that mortgage payments are due eventually must be liquidated by the borrower at full interest costs. In this sense, the benefits to borrowers from early-year reductions in nominal debt service payments under the equity-adjusted mortgage are less advantageous than those received under the GNMA incentive investment interest payments used to reduce the first 10 years of payments under the terms of S. 3193. The interest costs of the latter benefits are absorbed by GNMA.

There are other costs to the borrower, psychic as well as financial, very similar to those noted with reference to S. 3193. What happens if incomes do not rise in step with inflation, to say nothing of the possibilities of income interruption in the latter years of the mortgage term when payments are on a rising curve? In the event of a reversal of inflationary conditions, equity mortgage payment adjustments are upward not downward. What happens if this occurs in the early years of the mortgage, in conjunction with possible unemployment associated with a period of deflation? These are high risks to the borrower that are not compensated by the existence of mortgage insurance which protects the lender, not the borrower.

Other potential costs may be realized if the borrower must sell at any point during the initial 10 years when his mortgage liability can exceed the amount initially borrowed or even the original price of his house which may not have increased appreciably or at all due to temporary local market conditions or adverse neighborhood changes. Although avoidance of these possibilities is partially a function of appropriate mortgage underwriting procedures and practice, these are by no means infallible.

Relative to the tax-exempt "individual housing account," families who realize the benefits of this savings incentive are beneficiaries of a cost-free subsidy, except perhaps, for the psychic loss of not spending such savings for other useful purposes to the extent that the financial benefit of the tax-free savings succeed in overcoming intentions to spend these funds for competing purposes.

2. *The lender.*—Unlike the provisions of S. 3193 which is silent on the subject, lenders under the Brooke bill explicitly are protected by FHA mortgage insurance, and all the processing procedures that accompany this protection. Beyond this point, the attractiveness of the provisions of S. 3692 to lenders appear meagre. The following features of the bill appear of dubious value:

(a) This is a high-risk program, despite its insurance provisions. Only vigorous application of careful mortgage underwriting procedures can minimize the problems of accepting families whose potential income increases are not as bright as they would like to believe. A high rate of defaults even under an insured program is not a profitable activity for mortgage lenders to say nothing of the accompanying human dislocation and suffering.

(b) Lenders are left to cope with the problem of setting interest rates high enough to anticipate the future rate of inflation. This exacerbates the underwriting difficulties referred to in (a).

(c) The concept of statutorily mandated increases in mortgage loans during the initial years when such increases outrun the rate of amortization does not help lending institutions' cash flows or their ability to cope with the problem of disintermediation during periods of continued inflation.

(d) The administration costs of the complex of annual changes required for each individual mortgage will be prohibitive except for lenders with the most sophisticated electronic data processing capacity available to them. In summation, the salient elements of this program do not address basic problems of mortgage lenders with respect to level debt service mortgages that have been a source of severe difficulties

during periods of inflation. If anything, S. 3692 aggravates some of these problems—insufficient cash flow during inflationary periods—while offering no discernable improvements over the existing system.

3. *The Federal Government.*—The Federal Government assumes two major costs of this program. The first is that of insurance of equity adjusted mortgages whose risks are likely to be higher than average for a home insurance program. Second, is the cost of tax exemption on approved "individual housing accounts." Based upon HUD estimates, in both 1973 and 1974, 2.5 million renter households purchased their first home with aggregate downpayments of \$25 billion. Applying an average tax rate of 25 percent to this total, total taxes amount to \$6.25 billion.¹¹ Since these savings were applied to home purchases without benefit of subsidy, the question may be raised, to what extent would additional savings be accumulated if they were tax exempt? Assuming that the number of families and amount of savings would double, the tax subsidy would amount to \$12.5 billion to encourage the accumulation of \$50 billion of savings for housing, of which half probably would have been saved in any case. In this example, the cost to the Government would be fifty cents for each additional dollar of savings attracted by this program, since those that would have saved anyway now would have the benefit of subsidy. This may be regarded as a high price for the results achieved. Aside from the foregoing, the transfer payments to these savers through tax forgiveness raises the necessity of increased taxation elsewhere to offset these revenue losses.

Economic premises of the program and its effects upon:

1. *Inflation.*—The Brooke bill does not address the subject of inflation; it accepts inflation as a given condition of the economy. In this respect, both major components of this legislation would do nothing to stem inflationary forces. If anything, they would aggravate inflationary influences. Since the combination of tax-exempt savings and the equity adjusted mortgage provisions of the act would increase the number and proportion of renter families able to bid for new and existing housing, this result reasonably would ensue. Another outcome would, of course, be the expansion of new single-family home construction.

The "individual housing accounts" subsidy program to encourage housing savings similarly would expand both the number of families in the market and the dollars of equity investment available for downpayments. It consequently would increase inflationary pressures on new single-family suburban house prices which have been subject to rapidly rising price increases since 1970.

It should be noted at this point, that the major 1976 resurgence in housing has been in the single-family home sector. One-unit starts are headed for a figure of 1.1 million, rivaling the performance of the 3 record-breaking years, 1971-73 and exceeding that of any year in the 1960's. Prices have been strong and sales of new single-family houses apparently will exceed 600,000, joining the peak years 1971-73. Given this background and the prospects that 1977 will produce more

¹¹ Cf. statement of John C. Welcher, Deputy Assistant Secretary for Economic Affairs, before the Banking, Housing, and Urban Affairs Committee, Subcommittee on Housing, Aug. 9, 1976.

of the same, it appears clear that legislation to accelerate these trends will add to inflationary pressures in the owner-occupied sector of the housing market. The rental sector, meanwhile, appears to have difficulty in emerging from a slump that will not be helped by public assistance to the strong single-family sales market.

2. *Income levels served.*—The Brooke bill is not likely to reach families with incomes appreciably below \$15,000, despite the fact that the annual adjustments can cut debt service payments by as much as 48 percent (table 7). Lenders will be compelled to charge the full interest rates necessary to anticipate future inflation—rates which currently range between 8.75 to 9.5 percent. House prices at a median of \$44,000 for new homes and \$37,000 for existing homes cannot be supported by families below \$18,000 and \$15,000 respectively—particularly in connection with FHA underwriting standards for insurance purposes. The test for income appreciation will cause heavy fall-out even among \$15,000–\$18,000 families unless they are in a position to make more than minimum downpayments.

3. *National housing goals.*—Both the intent and effect of this program is aimed at widening the opportunities for home ownership among young families. It remains a question whether S. 3692 is the most appropriate or economic tool to achieve this goal, both in terms of its subsidy costs and the risks that it entails to borrowers, lenders, and the Government.

4. *Interest rates.*—This program will do nothing to avoid the requirement of lenders to maintain interest rates at levels high enough to offset anticipated inflation. In this respect, it is inferior to the Ashley-Brock bill.

5. *Mortgage lenders.*—It is difficult to see the appeal of this program (if there is any) to lenders. The “forced” lending requirement of the bill will aggravate the cash flow and disintermediation problems of lenders which will be shackled with effectively nonamortizing mortgages for at least 10 years. There is no provision for variable interest rates, so lenders must begin at high interest rates. This, in turn, will make difficult the mortgage underwriting procedures of lenders who must evaluate carefully future prospects of prospective borrowers to meet the rising curve of debt service payments over time.

6. *Administration.*—The program is the most complex, costly, and difficult to administer of all the programs under discussion.

7. *Program abuse.*—The most serious elements of program abuse appears to be implicit in the “individual housing accounts” subsidy program. This is apparent from the fact that several sections of the bill are devoted to safeguards against and penalties for violation of attempts to take tax exemption for savings for nonhousing purposes. In any program of this type such abuses are inevitable, primarily because of the difficulty in policing.

8. *Mobility of households.*—This type of program inevitably will inhibit the mobility of households for much the same reasons discussed with respect to S. 3193; that is, the disadvantageous position the owner finds himself in if he desires or it becomes necessary to sell during the first 10 years. This includes a mortgage equal to or larger than that initially incurred, which means a total dependence on inflationary gain in value of his house and his own increase in income.

Nowhere have proponents of these schemes paid much attention to the position that its participants will find themselves in as second homebuyers—a lack of equity buildup after the first 10 years of home ownership and facing the same increased house prices as buyers that they hope to realize as sellers. Given the fact that experience shows that average tenure of homeowners is 7 years, more than one-half the participants in the Brooke bill type of proposal will be in similarly disadvantaged circumstances as second homebuyers as they were as initial buyers. Not only will they have no equity buildup from their first house but any increase in the value of their first home will be nullified by the schedule of house prices they face as buyers of a second home. In essence, the only leverage that these families are left with is their own increase in income over the years relative to the house prices they face as second buyers. And if their tastes, or needs, have outrun the increase in their incomes, the effect on their mobility will be adverse.

V. PROPOSED HOME OWNERSHIP ASSISTANCE LOAN PROGRAM, DADE COUNTY, FLA.

Description

The Dade County home ownership assistance loan program is an interesting proposal to blend private and public funding to achieve a difficult end of increasing the rate of home ownership among low-income families in the income range of \$9,750 and \$13,500 in cleared urban renewal sites zoned for development with single-family houses. Its basic features include:

1. Conventional 35- to 65-percent first mortgage, 20 years, 9¼ percent (current market rate).
2. Dade County 30- to 60-percent second mortgage, 5-percent minimum downpayment, up to 40 years, 3-percent interest rate, no amortization during life of first mortgage unless income increases.
3. Limitation of incomes of applicants to a (1973) range of \$9,750 (two persons) to \$13,500 (eight persons).
4. Debt service payments plus taxes and insurance held to a range of 20 to 30 percent of annual adjusted gross income (section 236 definition) which necessitates establishment of minimum incomes depending upon price of the house.
5. Annual review and certification of homeowner's income is required to insure that mortgage payments remain consistent with goals of the program, for example, when debt service, taxes and insurance fall below 20 percent of annual income, second mortgage payments must be initiated to bring total payments up to 20 percent of income.
6. A counseling program is established for all purchasers.
7. In order to provide a degree of economic integration to the program, some families whose incomes exceed the prescribed income limits would be permitted to participate in the program with the quid pro quo that the subsidy component (3-percent second mortgage) could be substantially reduced for such families.
8. The program also could be applied to families otherwise eligible for an 80- or 90-percent first mortgage but who lack the downpayment funds. The second mortgage could be used to bridge this gap.
9. Asset limitations of \$2,000 for families with the head below age 62 would be applied; the corresponding figure for families whose head is over 62 is \$5,000.

10. Finally, the size of the house purchased must be consistent with the size of the family.

Problems addressed

This house financing proposal meets several objectives:

1. It solves the problem of undeveloped publicly owned sites by providing a mechanism to finance housing that reasonably can be produced on the sites.

2. The financing meets the dual housing goal of home ownership and the provision of housing for lower income families.

3. It utilizes existing conventional financing vehicles at shorter terms (20 years) and current interest rates ($8\frac{3}{4}$ to $9\frac{1}{4}$ percent).

4. It utilizes what is effectively a shallow subsidy program to accomplish its purpose. A house with an average price of \$30,000, with an \$18,500 9-percent, 20-year first mortgage and a \$10,000, 3-percent second mortgage could be purchased by a four-person family with a gross income of \$11,000 by paying 29 percent of its adjusted gross income of \$9,850 for debt service, taxes and insurance. The subsidy associated with the program would be \$10,000 less the present value of this sum returned with 3-percent interest over a maximum period of 40 years, or roughly \$3,000. Thus the cost to Dade County would be \$7,000 per family to enable families to own a new home who otherwise could not be in the market for a new house.

5. This program will complete the renewal responsibilities of Dade County by placing full taxpaying houses on these sites and providing ownership housing to modest-income families.

Costs

Aside from possible foreclosure losses and interest subsidies of about \$7,000 per house that will be borne by Dade County, this program entails no further costs to assist the necessary financing for the housing to be developed on its sites for lower income families other than administrative costs of identifying eligible purchasers and contracting with developers for construction of the housing. This subsidy is comparable with the GNMA outlays under S. 3193 both in magnitude and in the time period required to reimburse the Dade County agency for repayment of principal.

The borrowers will be major beneficiaries of this program although they will be responsible for mortgage repayments that will liquidate the full capital costs of their home although not all interest costs.

The first mortgage lenders are beneficiaries to the extent that these should be reasonably good quality loans since most of them will have low loan-to-value ratios backed up by the strong second mortgage support of Dade County.

Economic premises of the program and its effects upon

1. *Inflation.*—The Dade County program accommodates to the existing inflationary situation without aggravating it. By facilitating the use of reasonably conservative, not overlengthy mortgage lending terms, lenders will be supported with full market interest rates and a reasonably good cash flow in the form of 20-, or at most, 25-year mortgages.

Buyers are accommodated with a modest but steadily growing equity buildup from the first year consistent with the traditional experience of homebuyers. Finally, Dade County's outlay will be returned in full within a decade by restoration of the developed sites to the tax rolls. By and large, this program may be classified as relatively neutral with respect to its effects upon inflation.

2. *Income levels served.*—This program reaches moderate-income levels comparable to those aimed at both by the Ashley-Brock (S. 3193) and the Brooke (S. 3692) bills—families immediately below the levels that currently are bidders for houses in the market. Thus the program seeks to extend, within reasonable limits and costs, the ability of renter families to shift to home ownership. In this sense, the structuring of the Dade County program is simpler, more efficient and more effective than either the Ashley-Brock or the Brooke bills. Not only does this program reach the same generic income levels aimed at by S. 3193 but it services these families without the many complications entailed in the concept of committing anticipated income before it is earned. The Dade County families participating in this program will not run the same risks as those in the other programs mentioned above nor will they experience the same psychological hazards. In essence, this program is simpler, more effective and more consonant with traditional attitudes than either S. 3193 or S. 3692.

3. *National housing goals.*—The Dade County program is ingeniously designed to serve the basic national housing goals of the nation in two ways: it provides the means for families to help themselves to better housing, and housing that they own, at a minimum cost both administratively and dollarwise than is offered by any of the previous programs discussed.

4. *Interest rates.*—The program is reasonably neutral in its effect on interest rates. By accommodating moderate-term conventional mortgages (20 to 25 years), the sponsors take some small pressure off lenders' necessity to charge the maximum possible interest rates to anticipate future inflation.

5. *Mortgage lending institutions.*—The adoption of the Dade County approach on a large scale would permit the participation of mortgage lending institutions with safer (low loan-value ratio) shorter term mortgage loans that would provide a more rapid payback rate and lower risks to their cash flow situation. It is the type of program with which the private sector readily could cope.

6. *Administration.*—This program is the essence of simplicity with respect to administration. Its servicing could be accomplished by existing agencies without difficulty and at minimum cost.

7. *Program abuse.*—The basic simplicity of this program would not subject it to serious problems of program abuse except for the ever-likely possibility of income underreporting, a permanent hazard of any program based upon a means test.

8. *Mobility of households.*—This program comes nearer to affording normal mobility than most of the programs discussed earlier, particularly S. 3193 and S. 3692. The equity accumulation from the first year would make this an excellent vehicle for whatever mobility is required of the occupants.

VI. A COMMON SENSE SUBSIDY PROGRAM (NAHB)

Description

Program 1; straight front-end subsidy: Under this program the Federal Government would make a one-time, direct mortgage interest differential payment, that is, front-end subsidy. The payment would represent the difference between the current market rate and a variable (based on sales price) below-market rate (table 7). This payment would be secured by a noninterest bearing trust in favor of the Government. It would be "recaptured" at the time of sale.

There are neither income nor mortgage limits; sales price is limited to \$50,000 for new single-family or condominium units only, conventionally financed. Below market rate is keyed to the sales price, ranging from 6 percent for a \$25,000 house (or less) to 7.25 percent for a \$45,000 to \$50,000 house. Downpayments similarly range from 3 percent to 9.5 percent.

TABLE 7.—PARAMETERS OF NAHB FRONT END SUBSIDY PROGRAM BASED UPON 30-YEAR TERM AND MARKET RATE OF 9 PERCENT (PROGRAM 1)

Sales price	Below market interest rate	Assumed cost	Down payment	Mortgage	Subsidy	Monthly debt service	
						Subsidized	Market
Below \$25,000.....	6.0	\$25,000	\$750	\$24,250	\$4,937.30	\$145	\$195
\$25,000 to \$30,000.....	6.25	30,000	1,250	28,750	5,379.13	177	231
\$30,000 to \$35,000.....	6.5	35,000	1,750	33,250	5,672.45	210	268
\$35,000 to \$40,000.....	6.75	40,000	2,750	37,250	5,736.50	242	300
\$40,000 to \$45,000.....	7.0	45,000	3,750	41,250	5,659.50	274	332
\$45,000 to \$50,000.....	7.25	50,000	4,750	45,250	5,448.10	309	364

Source: John C. Hart, "A Common Sense Subsidy Program," NAHB, September 1976.

The effect of this front-end subsidy is to reduce monthly carrying charges by 25 percent for the lowest priced house (\$25,000) and by 15 percent for the \$50,000 house. The calculated incomes to afford these houses drop 19 percent—from \$12,766 to \$10,379 for the \$25,000 house down to 11 percent—from \$24,277 to \$21,617 for the \$55,000 house.

This proposal in principle is very similar to the Dade County system except that it removes the income restrictions imposed by the latter program.

Programs 2 and 3 are variants of program 1. These introduce the feature of HUD's graduated payment system to reduce the aggregate subsidy by nearly half. The technique used is to increase the interest rate by one quarter of one percentage point each year until the market rate (9 percent) is reached. Proposal 2 uses the single-payment front-end subsidy method while proposal 3 requires annual decreasing subsidy payments from 7 to 12 years, depending upon the period of time it takes to shift from the subsidized rate to the market rate in annual increments of one-fourth percentage points. All three programs may be characterized as shallow subsidy systems in terms of the relatively modest per unit costs involved, which ranges from \$5,000 to less than \$6,000 for program 1, from \$2,300 to \$3,100 for program 2 and from \$2,700 to \$3,900 for program 3.

Finally, there is a recapture provision of the subsidy upon sale of the house. Since the subsidy is based upon 12-year repayment calculations, if the house is sold before 12 years then only a pro-rata portion of the subsidy is recaptured.

Problems addressed

The proposal is addressed principally to the expansion of homeowner opportunities to renter families who presently are priced out of the market. A second objective is to accomplish this with minimum subsidy. The proposals as they are set out address themselves to these requirements in a sophisticated manner. They are priced out specifically to establish the costs of subsidizing 100,000 new units with sales prices ranging from \$25,000 to \$50,000 and subsidy costs calculated at an average of \$5,528 per unit, \$2,847 per unit or \$3,550 per unit depending upon the approach chosen. The "graduated incentives" (higher interest rates for higher priced houses) are designed not only to minimize subsidies but to "encourage families . . . to select housing within their financial capabilities." It is also hoped that the program would "promote active competition among all builders to design and produce new housing within the scope of these programs," including provision of "more compact housing using less energy and better utilization of land."

Costs

The costs of this program are borne principally by the Federal Government and secondarily by the buyer. Since the problems of the lender are not directly addressed by these proposals, the lender comes out "held harmless" by these proposals—neither with advantage nor disadvantage.

1. *The Federal Government.*—In an approach similar to the GNMA "incentive investment interest payments" of the Ashley-Brock bill (S. 3193), it is proposed that the Federal Government underwrite the NAHB "front-end subsidy" program. The cost per 100,000 homes subsidized is reasonably modest—\$2.54 billion for a 6-year program (an average of \$420 million annually) for a total of 600,000 homes, including an estimate of \$774 million recaptured through "second trust" repayments of the subsidy upon sale. This works out to an overall average one-time subsidy of \$4,233 per unit to reduce the interest rate of a 30-year mortgage an average of 2.375 percentage points in the most expensive program 1. The interest subsidy for this price tag ranges from 1.75 to 3 percentage points depending upon the price of the house (table 7). For a 30-year, \$37,500 mortgage the resulting debt service reduction amounts to \$59 per month, from \$302 to \$243 or a decrease of 19.5 percent in debt service that otherwise would be required under the current 9-percent interest rate.

When the subsidy is reduced (in program 2) by one-quarter percentage point each year until the 9-percent conventional interest rate is reached, the subsidy amount is cut by about half. This is a rough parallel to the HUD graduated mortgage payment plan and provides probably the most interesting combination of a modest subsidy coupled with gradual increases in the borrower's financial responsibilities over a period of 7 to 12 years, depending upon the sales price of the house (table 8).

Program 3 is identical with program 2 except that the payments to the lender are in the form of annual contributions until the conventional (9 percent) interest rate is reached. This procedure replaces the simpler single-payment subsidy used in program 2. In real cost terms programs 2 and 3 are virtually identical.

TABLE 8.—PARAMETERS OF NAHB GRADUATED FRONT END SUBSIDY (7 TO 12 YR); 30-YEAR MORTGAGE AT 9 PERCENT

Sales price and subsidy rate	Equity down	Mortgage	Per unit subsidy	Number of units	Estimated total subsidy
\$25,000—6 percent plus $\frac{1}{4}$ percent each year to 12 yr.....	\$750	\$24,250	\$2,978.86	10,000	\$29,788,600
\$30,000—6.25 percent plus $\frac{1}{4}$ percent each year to 11 yr.....	1,250	28,750	3,071.51	20,000	61,430,200
\$35,000—6.50 percent plus $\frac{1}{4}$ percent each year to 10 yr.....	1,750	33,250	3,042.44	20,000	60,848,800
\$40,000—6.75 percent plus $\frac{1}{4}$ percent each year to 9 yr.....	2,750	37,250	2,869.48	20,000	57,389,600
\$45,000—7 percent plus $\frac{1}{4}$ percent each year to 8 yr.....	3,750	41,250	2,614.17	20,000	52,283,400
\$50,000—7.25 percent plus $\frac{1}{4}$ percent each year to 7 yr.....	4,750	45,250	2,295.50	10,000	22,955,000
Total.....				100,000	284,696,000

Source: John C. Hart, "A Common Sense Subsidy Program," NAHB, September 1976, [table 1].

2. *The borrower.*—In program 1, the borrower's life is simple. He pays a flat 6 percent level debt service rate for the life of the mortgage or until he sells his house, at which time he must reimburse the Government for the amount of his subsidy from the proceeds of the sale.

Programs 2 and 3 are slightly more complicated because the borrower's mortgage payments increase each year as a result of an annual one-fourth percentage point increase in interest rate. This amounts to roughly \$6 a month increase in debt service each year on a \$37,500 mortgage. This single statistic exemplifies an interesting combination of a modest subsidy to accomplish an important housing goal while increasing the buyer's financial responsibilities at a reasonably modest pace.

3. *The lender.*—Under these programs, lenders are left whole. Although not gaining significantly, they obtain the market interest rate equivalent (9 percent) through the subsidy. The default rate should be no more than average, so it should be a reasonable program to manage.

Economic premises of the program and its effects upon

1. *Inflation.*—Programs 1, 2, and 3 would be reasonably neutral in their impact on inflationary trends. The subsidy component is sufficiently modest to have only a mild effect on inflation. Interest rates should not be affected unless the increase in construction volume of 100,000 units were to affect the mortgage market sufficiently to move up interest rates slightly.

2. *Income levels served.*—Lacking any restriction on incomes, the popularity of this program might require a lottery to choose its eligible recipients. There are both diseconomies as well as public policy problems in opening up this program to families irrespective of their incomes:

(a) To the extent that higher-income families are benefited who would have purchased a house without assistance, the subsidy funds are wasted.

(b) Conversely, lower-income families who need the subsidy tend to be crowded out under such a system.

Given the otherwise admirable qualities of this subsidy system, there is no reason why an income criteria could not be added to avoid these undesirable results.

3. *National housing goals.*—With the addition of an income criterion, this subsidy system would serve national housing goals well. It would expand the demand for new housing at modest public cost; it would service the needs of modest income families and it would be a simple program to administer with its single-payment principle.

4. *Interest rates.*—This program's effects on interest rates should basically be neutral unless, for whatever reasons, the Government chose to augment new construction by one-half million units rather than 100,000 or 200,000.

5. Mortgage lending institutions should find this a very easy program to support without qualification even though its terms do not in any way address lender problems of disintermediation or mortgage payment tilt.

6. Administration should cause few difficulties even with the annually changing interest rate schedule.

EVALUATION OF THE SECTION 236 SUBSIDIZED HOUSING PROGRAM

(By Philip N. Brownstein*)

An assessment of the effectiveness of the section 236 program requires some review of the subsidized housing programs which preceded section 236. Except for public housing directed at a limited low-income market, Federal involvement in multifamily housing prior to the 1950's consisted of providing mortgage insurance at market interest rates for rental housing occupied primarily by moderate income persons.¹ Gradually it became apparent that the combination of public housing for the lowest income groups and standard mortgage insurance programs for the middle income groups was leaving a gap of lower moderate-income American families who did not have a "suitable living environment" as promised in the Housing Act of 1949.

With this realization came the trend toward a deeper Federal involvement in and assistance to multifamily housing. The beginning of this deeper involvement is probably signalled by the section 202 program, added by the Housing Act of 1959 (12 U.S.C. 1701q), which provided for below market rate direct mortgage loans for multifamily rental housing for the elderly and handicapped. Soon thereafter, the section 221 mortgage insurance program was amended by the Housing Act of 1961 (12 U.S.C. 17151), to provide for below market interest rate (BMIR) mortgage loans for certain multifamily rental housing built under the existing section 221(d)(3) program. These BMIR loans were financed through direct Federal purchase from the special assistance funds of the Federal National Mortgage Association (FNMA). The Senior Citizens Housing Act of 1962 added section 215 (42 U.S.C. 1485) with its direct loans, insurance and other

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¹The term "rental housing" when used herein generally also includes cooperative housing.

financial assistance for low-income, elderly persons, and families in rural areas. The Housing Act of 1964 added § 516 (42 U.S.C. 1486) with financial assistance for low rent housing for domestic farm labor. The rent supplement program, section 101, from the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s), allowed HUD to make payments to owners of multifamily housing on behalf of elderly persons, handicapped persons, displaced persons, disaster victims, and residents of substandard housing and the mortgage was insured at a market interest rate if the owner had mortgage insurance under section 221(d)(3) of the National Housing Act. On an "experimental basis" rent supplement payments could also be made to owners of projects receiving aid under section 221(d)(3) BMIR, section 202 and section 231 (mortgage insurance for elderly rental housing). The rent supplement program did and does serve very low-income groups who would generally be qualified for public housing and thus aids in providing a private enterprise alternative to the public housing program for this income level.

THE BASIC SECTION 236 PROGRAM

The Housing and Urban Development Act of 1968 included a major reaffirmation of the goals stated in the Housing Act of 1949 with a Federal commitment to assist in the provision of a specific number of units:

The Congress reaffirms this national housing goal and determines that it can be substantially achieved in the next decade by the construction or rehabilitation of 23 million housing units, 6 million of these for low and moderate income families. (42 U.S.C. 1441a)

In the multifamily rental area, the main contribution of the HUD Act of 1968 was the addition of the section 236 program (12 U.S.C. 17152-1) which is primarily composed of mortgage insurance and interest reduction subsidy payments by the Federal Government to the lender on behalf of the owner of qualified multifamily housing. The interest reduction payments reduce the interest costs and thereby reduce the amount of rent it is necessary to charge the tenants to cover the monthly expenditures for the projects.

The statute itself states the purpose of the section 236 program is "reducing rentals for lower income families." (12 U.S.C. 1715z-1(a).) However, official and unofficial legislative history and commentary give a more detailed insight into the reasons and objectives behind the development of section 236. The primary reason for shifting to an interest subsidy format instead of the direct Federal expenditure programs such as section 202 and section 221(d)(3) BMIR was that the latter two programs ran into problems of limited availability of funds and related low volume of productivity of housing. The direct expenditure programs had severe initial budget impact and a strong immediate sensitivity to increased building costs. The interest subsidy format increases the productivity potential of Federal aid while spreading out the actual Federal expenditures over longer periods of time. Section 236 provides for a much greater involvement of the private sector in the production of housing for low- and moderate-income persons than the direct expenditure and public housing programs. It was also hoped that section 236 would result in lower rent payment levels since, as discussed below, the owner's monthly

payments would be calculated on the basis of a 1-percent mortgage rather than a 3-percent mortgage as in section 202 and section 221(d)(3) BMIR. The framers of the section 236 program also had in mind a variety of other objectives such as the assistance of unstable or declining neighborhoods and the stimulation of the economy, particularly the construction industry.

The eligibility requirements for projects under section 236 are similar to the requirements under section 221(d)(3). The project must be rental or cooperative housing designed for occupancy by lower-income families or persons. The project must contain five or more dwelling units which may be single-family detached, row, garden, or multifamily (elevator) structures on contiguous or non-contiguous sites. As a general rule the projects must involve new or substantially rehabilitated existing construction. However, under the State/local noninsured variation of section 236, interest subsidy payments may be made on behalf of any type of existing units. The project must be designed so that it meets the basic rent and other requirements discussed in the following paragraphs.

The eligibility requirements for owners or mortgagors under section 236 are again similar to the requirements of section 221. As a general rule an owner must fit into one of the following categories: a private, nonprofit entity; a cooperative; a limited dividend or distribution (profitmaking) entity regulated by HUD under 24 C.F.R. 236.50. The regulations also provide for two other types of mortgagors: builder/sellers (who intend to sell the project to a nonprofit entity) and investor/sponsors (who intend to sell the project to a cooperative). However, these last two types of mortgagors are rarely found as sponsors of projects under the section 236 program as it has evolved in practice.

The distinctive element of the section 236 program is the direct cash payments made to the lender on behalf of the owner. The best known of these is the interest reduction payment: The difference between the monthly payment for principal, interest and mortgage insurance premium which the owner is obligated to pay under the actual mortgage for the project and the monthly payment for principal and interest which the owner would be obligated to pay if the mortgage bore an interest rate of 1 percent per annum. As part of Section 236, HUD also makes service expense payments to the lender in an amount deemed appropriate by HUD to reimburse the lender for its expenses in carrying the mortgage. Additionally, all projects eligible for the interest reduction subsidy payments are also eligible for mortgage insurance under Section 236 including insurance for advances during the construction period. This built-in financing mechanism is an important distinction from the current section 8 program which provides rent subsidy but no mortgage insurance.

Mortgages involved in the section 236 program must have certain specific characteristics. Originally there was a maximum total mortgage limit of \$12,500,000 (taken from the old Section 211(d)(3) program). However, this limit was removed by the Housing and Community Development Act of 1974. Today maximum mortgage limits are only on a per-unit basis and they currently vary between \$11,240

(no bedroom, nonelevator) to \$32,000 (4 bedrooms, elevator). These per unit amounts have been increased several times during the life of the section 236 program and it has always been possible for the limits to be increased at HUD's discretion in high cost areas by 75 percent and by another 50 percent more in Alaska, Guam, and Hawaii. The maximum maturity or amortization period of the mortgage must be satisfactory to the Federal Housing Commissioner but is no more than 40 years except under the State/local noninsured variation of the section 236 program where the mortgage may run for 50 years.

In calculating loan-to-value ratios for newly constructed projects, where the owner is a nonprofit or cooperative entity, the mortgage may be 100 percent of FHA's estimate of replacement costs (land, physical improvements, onsite utilities, architect's fees, taxes, interest during construction, and miscellaneous charges). Where the owner is a limited-dividend entity (private, profitmaking business), the mortgage may not exceed 90 percent of the replacement cost which is defined as above including the builder's and sponsor's profit and risk allowance (BSPRA) of 10 percent of the above items minus land. In calculating loan-to-value ratios for repair or rehabilitation projects, where the owner is a nonprofit or cooperative group, the mortgage may be 100 percent of the estimated cost of repairs or rehabilitation plus FHA's estimate of the value before repairs or rehabilitation. Where the owner is a limited-divided (profitmaking) entity, the maximum mortgage is 90 percent of the estimated cost of repairs or rehabilitation plus FHA's estimate of the value before repairs or rehabilitation. The mortgage in any of the above situations may currently bear an actual maximum interest rate of 9 percent. (This rate has been changed several times.) But of course, the effective interest rate from the owner's perspective is reduced by the interest reduction subsidy payments discussed above.

In analyzing what type of tenants are eligible to have subsidy payments made on their behalf, under section 236 as it was originally passed, not more than 20 percent of the subsidy payments could be made with respect to families whose income exceeded 135 percent of the maximum income limits for initial occupancy in public housing. The original section 236 statute also included a preference for "those families whose incomes are within the lowest practicable limits for obtaining rental accommodations in projects assisted under this section." (12 U.S.C. 1715 z-1(i)(2)). This preference for the lowest income families was removed by the Housing and Community Development Act of 1974 and the basic income standard was also changed by that act. Section 236 now provides that interest subsidy payments shall only be made on behalf of tenants who incomes do not exceed 80 percent of the median-family income for the area (with adjustments for family size and exceptions for high-cost and low-income areas at HUD's discretion).

Initial occupancy of section 236 projects was originally restricted to tenants meeting the following characteristics:

(a) Family: Two or more persons related by blood, marriage or operation of law (including families of military personnel who receive preference).

(b) Elderly person: Over age 62.

(c) Displaced person: A person forced to move from his/her existing residence by urban renewal, Government action or national disaster.

(d) Handicapped person: A person with an impairment which is expected to be of long, continued and indefinite duration, which substantially impedes his/her ability to live independently and is of such a nature that such ability could be improved by more suitable housing conditions.

(e) Single person: Less than 62 years of age (originally limited to 10 percent of the dwelling units in any single section 236 project).

As of September 20, 1976, HUD has removed these categories and limitations from its initial occupancy regulations and initial occupancy is now available to any tenant who meets the income requirements discussed above.² But there is still the statutory requirement that at least 20 percent of the total amount of interest subsidy contracts under section 236 must be made to projects which are planned in whole or in part for occupancy by elderly or handicapped families. Also, displaced and military personnel still receive regulatory preference in certain situations.

In calculating the tenant's rent in a section 236 project, it is first necessary to determine the fair market monthly rental charge for the unit in which the tenant lives. This charge is determined on the basis of operating the project with the payments of principal, interest (at the market rate) and mortgage insurance premium which the owner is obligated to pay under the terms of the actual mortgage on the project. The next step is to calculate the basic monthly rental charge which is determined by operating the project with the payment of principal and interest due under a mortgage bearing interest at a rate of 1 percent per annum.³ The third step involves calculating the tenant's adjusted monthly income which is one-twelfth of his/her gross annual income (the total income before taxes and other deductions received by all members of the household), minus 5 percent of the gross annual income, minus unusual or temporary income, minus an amount equal to \$300 for each minor person who is a member of the tenant's immediate family and living with the family, and minus the earnings of any such minor person. Once the above three calculations have been made, the actual monthly rental charge paid by a tenant eligible for subsidy is 25 percent of the tenant's adjusted monthly income or the basic rental charge, whichever is greater (but not more than the fair market rental charge). The monthly rental paid by unsubsidized, ineligible or over-income tenants is simply equal to the fair market rental charge.

Section 236 contains two basic provisions designed as safeguards against abuse. First of all, construction expenses must be cost certified. And secondly, tenant income reports must be verified and recertified. The statute requires review of tenant income at intervals of 2 years or less, but the regulations currently require annual recertification.

² See 24 CFR 236.70(a) as amended by 41 F.R. 40465. Tenants who do not meet the income requirements and are not eligible for subsidies may still live in section 236 projects after initial rent-up as long as they pay the fair market rent as discussed below.

³ The formulas for the fair market and basic monthly rental charges can be adjusted if there is separate utility metering. See 12 U.S.C. 1715z-1(f)(1).

RELATED FEDERAL INVOLVEMENTS

Within the bounds of the § 236 program, there are several provisions for Federal involvement which complement the provisions for mortgage insurance and direct cash payments to lenders. For example, as mentioned above, projects which are financed under State and local programs may receive § 236 interest subsidy payments. These types of projects offer several significant variations from FHA insured projects. First of all, if they do not require FHA mortgage insurance, the mortgage involved (and therefore the subsidy) may be 50 instead of 40 years in duration. The projects are not subject to HUD statutory mortgage limits and accordingly may have larger room sizes or include greater amenities. Also, under these State and local programs where there is no mortgage insurance, there are no Davis-Bacon (prevailing wage) requirements which may reduce the construction expenses for the projects. In theory it was contemplated that savings due to tax exempt bond financing and nonuse of Federal mortgage insurance would permit these extras at no increase in subsidy dollars over the insured § 236 program. Section 236 also provides for cooperation with the Farmers Home Administration for housing in rural areas and small towns and it allows for the construction of community and commercial facilities in connection with § 236 projects.

The Housing and Community Development Act of 1974 added two other significant programs to § 236 to complement the interest reduction payments to lenders. The first of these amendments provided for additional rental assistance payments on behalf of subsidized tenants whose incomes are too low for them to afford even the basic rent with 25 percent of their income. This so-called "deep subsidy" was intended for approximately 20 percent of the units in any § 236 project but this percentage can and has been raised or lowered at HUD's discretion. The amount of this rental assistance has been amended somewhat by the Housing Appropriations Act of 1976 so that it is now calculated on the basis of the difference between 25 percent of the tenant's income and the basic rent including the amount allowed for utilities in a project with separate utility metering.

The second significant addition by the Housing and Community Development Act of 1974 was the provision for operating subsidy payments. This was intended to provide payments from HUD to the owner of the project to help the owner cover tax and utility bill increases beyond the owner's control. This aspect of § 236 has never been implemented by HUD except under court orders challenging the impoundment of the fund from which these payments were to come.⁴

Beyond the bounds of section 236 itself, there are several other Federal programs which complement some of the basic purposes or

⁴ These operating subsidy moneys are held in a reserve fund composed of rentals returned by owners to HUD where the owners had collected rental fees in excess of the basic monthly rent. Although HUD has not implemented Congress' operating subsidy plan, it should be pointed out that in 1975 HUD administratively revised the method of calculating excess rents so that in effect owners could apply these directly to cover certain operating losses. But a 1976 court order prohibits HUD from making refunds from the reserve fund to owners who did not make these allowed deductions prior to 1975. HUD's Appropriation Act for the fiscal year 1977 now authorizes HUD to disburse moneys from the fund to other programs which may diffuse the impoundment issue for the near future. See GAO Report CED-76-146, 19-30 (1976).

objectives of section 236. For example, the Housing and Urban Development Act of 1965 created the FNMA/GNMA tandem plan (12 U.S.C. 1720j). Under this program GNMA issues a commitment to purchase a permanent mortgage qualifying for this assistance at a predetermined price that is more favorable than that available in the marketplace. This commitment is transferred to FNMA and when the mortgage is ready for delivery GNMA uses Federal moneys directly from its special assistance funds to pay FNMA the difference between the committed price and the price which FNMA would have paid in its regular market purchase program. When section 236 came into existence in 1968, it became possible to use the tandem plan in conjunction with section 236 mortgages. The Housing and Urban Development Act of 1968 added another complementary program by providing for technical assistance and interest-free loans to aid nonprofit sponsors in planning, assembling, and obtaining financing for low- and moderate-income housing (12 U.S.C. 1701x). Further, the HUD Act of 1968 provided that the rent supplement program previously created in 1965 (see above) could be piggybacked onto section 236 interest subsidy payments. Rent supplement payments could be made on behalf of 40 percent of the tenants living in projects financed under section 236.⁵ The Housing and Community Development Act of 1974 created the section 8 housing assistance payments program (42 U.S.C. 1437f) which provided payments to owners of existing or newly constructed units on behalf of lower-income families who wish to move into these units. As with several of the other programs above, these payments can be piggybacked onto section 236 interest subsidy payments to deepen the subsidy.

In another complementary Federal program, section 212 of the National Housing Act requires that the Davis-Bacon Act "prevailing wage" standards (40 U.S.C. 276a) be observed in section 236 projects. (However, it should be noted that there are no Davis-Bacon requirements on State/local section 236 projects unless they are federally insured as well as subsidized.) There are also Federal statutes, regulations, case law and agreements (negotiated with social, political, or legal considerations) which require that minority or female individuals or businesses be employed by those connected with Federal programs such as section 236. And Federal statutes, regulations, and case law require that housing be available to individuals and families regardless of sex or race. And lastly it must be mentioned that the profit-oriented owners or investors in section 236 projects have received and do receive special tax treatment under current or previous Federal tax law such as: Preferential holding periods limiting recapture of depreciation as ordinary income; deferral of taxes on gains by rolling over or reinvesting in similar type projects; interest and taxes not capitalized during construction but written off as expenses with a longer transition period than nonsubsidized housing. All this preferential tax treatment costs the Federal Government money in the sense that the Treasury does without tax receipts which it otherwise would have been entitled to receive from these taxpayers. Therefore, this type of tax treatment could be considered an additional subsidy com-

⁵ However, since the addition of the specific sec. 236 rental assistance program in 1974, the older rental supplement program is being phased out in sec. 236 projects in favor of this more recent "deep subsidy" program more directly tailored to sec. 236.

plementing the section 236 program. (Of course, it is unlikely investors would be interested in providing needed capital in the absence of such incentives and the projects would not have been built.)

SOME ASSUMPTIONS BEHIND THE SECTION 236 PROGRAM AND RELATED FEDERAL INVOLVEMENT

The section 236 program and other production-oriented Government housing programs assume that the demand for rental housing for low- and moderate-income households is greater than the private market can supply without Federal assistance. Because there is a low supply of such housing (at least in certain geographical areas), there is a gap of poorly housed people between those that can get into public housing and those who can afford market rate housing. There is, of course, also a shortage in many areas of housing for people eligible for public housing. Section 236 is also premised on the assumption that subsidizing mortgage interest rates will encourage increased production of such low- and moderate-income housing and thus assist in the closing of this gap. Inasmuch as interest subsidies alone may not entirely close the gap, there was a recognized need for certain other types of Federal payments to provide a deeper subsidy, such as the rent supplement program and the operating subsidy program. It has also been thought desirable for projects to achieve social objectives such as having economic and racial mixing in the employment pattern during construction and in the residency pattern after construction. It was expected that sites for the projects would be available in locations where the target population wants and is able to live and that restrictive zoning and other geographic discrimination would not close off these programs. And lastly it has been assumed that the section 236 program and related Federal involvements can be administered and regulated by Federal housing personnel of average competence and that the programs will be carried out by developers, contractors, and lenders without costly abuses.

SUMMARY OF GENERAL TRENDS

In comparing the original section 236 program as passed in 1968 to later amendments, there appears a legislative trend toward deeper interest and rental subsidies including such elements as (1) an expansion of the income groups covered and an increasing flexibility of the income requirement; (2) the addition of a rental assistance program directly tailored to section 236 projects; (3) the addition of the operating subsidy program; and (4) the provision for coverage of utility charges where there is separate utility metering. But note that a 1974 amendment to section 236 did remove the preference for the lowest income tenants. Also, the average income of tenants housed in section 236 units has been gradually increasing. For example, HUD Budgeting Office statistics show that the gross annual average income for a section 236 tenant for the year ending September 1973 was \$5,476 while for the year ending September 1976 it was \$5,747. Of course, such an increase may be meaningless since it may reflect only the general inflation in our economy and not an increase in actual disposable moneys available to the average tenant.

In January 1973, HUD administratively suspended the section 236 program and the nonprofit sponsor assistance program along with all other subsidized housing programs. And HUD has never implemented the operating subsidy provisions of section 236 except where required by court order. These administrative actions make a reasoned summary and analysis of section 236 and related Federal involvement difficult. In recent years there has undoubtedly been an artificially low number of new construction starts because of these administrative actions. Also there may have been an artificially high number of defaults due to the failure of owners to receive the operating subsidy moneys which Congress intended that they should have.

PERCEIVED PROBLEMS WITH SECTION 236

One of the first criticisms usually levied at the section 236 program is that the subsidy is tied to debt service or to the capital cost of the housing units rather than to the specific needs of the population to be served. This tie is perhaps inevitable to a certain extent in any program which is geared primarily toward increasing the supply or production of housing. Its inflexibility is somewhat ameliorated when section 236 is coordinated with more demand-oriented complementary programs such as rent supplement and section 8. Also, the addition of the rental assistance and operating subsidy plans directly to the section 236 program in 1974 seems to be a reasonable effort to respond to this criticism.

Another common criticism of the section 236 program is that insurance failures (mortgage foreclosures and assignments to HUD due to default in mortgage payments) are too high, greatly increasing the cost of the program. In attempting to analyze the validity of this criticism, a series of calculations have been made based on statistics in HUD's Directory of Multifamily Project Mortgage Insurance Programs (by project status as of June 30, 1976).⁶ These are the latest statistics available and indicate that approximately 12.40 percent of all section 236 projects have insurance failures (with the mortgage either having been assigned to HUD or the project having been acquired by HUD through foreclosure). In breaking down these calculations further, it is interesting to note that of these projects only somewhat over 2 percent have actually been acquired by HUD while somewhat over 10 percent had the mortgages assigned to HUD. This is significant because where the mortgage has been assigned, there is still the possibility of working out the owner's financial problems and this often occurs. It is also interesting to analyze the insurance failure statistics by the type of sponsor or owner involved. Of the projects developed by nonprofit organizations, 22.3 percent are in this category, while only 12.5 percent of the projects developed by cooperatives and 8.8 percent of the projects developed by profitmaking groups have resulted in insurance failures. Of course, as the General Accounting Office has noted, the average age of section 236 mortgages is still less than 3 years, leaving many risky years coming up in the near future for many of the projects where the insurance is still in force.⁷

⁶ Pp. 238-293.

⁷ GAO Staff Paper: "A Comparative Analysis of Subsidized Housing Costs," D-76-44. 19 (1976).

Offsetting the factors which normally cause defaults is the fact that construction costs have risen substantially and similar housing would be much more costly to produce, thus significantly increasing rentals. Because of this, it is difficult to predict whether or not the current insurance failure figures will continue to be typical in the future. However, looking back over the failure rates during the last 3 to 4 years in the section 236 program, there has been no significant rate of increase in the number of failures and therefore there is no reason to expect any such large increases in the future. In trying to decide whether or not these are acceptable failure rates for a below-market housing program, it is important to keep in mind that section 236 has involved over 4,000 multifamily rental housing projects and has produced almost 450,000 rental units.⁸

It has also been stated that, even excluding defaults, the direct costs for section 236 housing are too high and there is little incentive in the program for them to be lower. This may appear to be a problem, particularly when comparing section 236 to other housing programs and when one adds the cost of tax incentives, the Tandem plan, and other complementary programs.

A General Accounting Office study concludes that public housing and section 8 provide housing at less cost to the Federal Government than section 236.⁹ However, GAO's results are premised on the questionable assumption that the families in all three projects will have the same average annual income whereas, in fact, public housing and section 8 are clearly geared to lower income groups than section 236. Also, there are many other factors to weigh besides cost to the Federal Government. For example, public housing has less private involvement in the construction, ownership and management of the housing projects. It also means that local governments may have their tax rolls reduced. Also tenants and others must deal with the negative reputation and stigma of public housing and direct public ownership. Section 8 for existing units, the housing allowance program, and other leasing programs do not provide for the production of new units and are therefore useful only in areas where there is already an adequate supply of housing. Even section 8 as applied to new construction may never be as successful as section 236 in producing a large number of new units. Initially section 8 appeared to have serious financing problems including a dependence on financing by State and local agencies. This has been somewhat ameliorated by the provision of financing under section 221(d)(4) in conjunction with the Tandem plan. But many sponsors complain that the attitude of FHA underwriters under this unsubsidized mortgage insurance program thwarts obtaining a mortgage necessary to support project development cost. This is contrasted to section 236 which has the built-in tie to mortgage insurance. Furthermore, there continues to be a problem in privately financing the projects in view of the low market rentals which have been established for some locations making the projects infeasible. Although a reversion to direct Federal expenditure programs of the section 202 or section 221(d)(3) BMIR type could produce new units for less cost due to interest savings, there still remain the issues of large initial

⁸ Figures include those projects and units converted from sec. 202 to sec. 236 under 24 C.F.R. 236.40.

⁹ GAO staff paper, supra at 7-22.

budget impact with lessened private involvement which were raised in the 1960's when Congress first decided to initiate the section 236 program.

There have been numerous criticisms concerning the failure of Federal personnel or project owners to administer or to carry out properly certain aspects of the section 236 program. For example, it has been stated that FHA underwriters have failed to use adequate techniques to evaluate land costs when determining the replacement value for the purpose of calculating the maximum mortgage. As another example, there appears to be a tendency of sponsors of section 236 projects to underestimate expected operating costs. Also, the GAO has accused owners of failing to verify or recertify tenant income in section 236 projects.¹⁰ Where these problems exist, it appears that they can be corrected by an improvement in the administrative procedures for the selection of sponsors and an improvement in administrative supervision over the underwriting, development, and management phases of the projects.

A serious problem for the section 236 program since it was initially enacted has been the chronic underfunding and underutilization of funds for the program. This was obviously exacerbated by the entire suspension of the program in January 1973, making it very difficult to assess the full effect of section 236 had it ever been carried out to the extent originally envisioned. A new executive administration and a newly enthusiastic Federal legislature could easily correct this problem, but the scope of the program will inevitably be limited by budgetary constraints.

It has been noted that the section 236 program is not equitably distributed among qualified income groups or geographical locations. This may be partly the result of faulty program administration and funding. But this is also encouraged by local restrictions (such as zoning) and the basic dependence of most FHA programs on sponsor initiation. Such a problem could be partly corrected by eliminating traditional income limits in section 236 projects and requiring the payment of a certain percentage of income for rent up to the market rent regardless of the total family income.

State and local governments and their champions have complained that they are not given a large enough role in a program such as section 236. Many have proposed special revenue sharing or housing block grant programs which would provide for more State and local involvement. Although it is true that State and local governments have a very minor role in section 236 (except for the State/local noninsured variation of section 236), most State and local governments have never volunteered to take a large share of the responsibility in the housing production area. Also, these governments seem even more prone to the problem of political abuse than the Federal Government. And, of course, since Congress generally budgets on an annual basis, this would present a major planning problem for a State or local government attempting to provide a long-term housing program. If a revenue sharing or a block grant program were adopted as the only approach to housing supply, what could the Federal Govern-

¹⁰ See the recent GAO report, "Little Accomplished in Insuring That Proper Rents Are Charged Under the Section 236 Rental Assistance and Housing Program," CED-76-146, 1-18 (1976).

ment do about the housing problems of citizens in States which were unwilling or unable to utilize the grants?

It has been pointed out that the Davis-Bacon Act may unfairly divert income from the provision of housing to a small group of construction workers who are being paid higher than actual market rates for local labor due to inaccurate "prevailing wage determinations" by the Department of Labor. Although this may be a problem, there appears to be very little detailed or statistical analysis on the seriousness of its impact. Due to the importance and wide-reaching effects of this issue, it would be premature to delineate the problem further or to recommend changes in this area without a type of analysis which is beyond the scope of this paper.

It has been charged that Government-sponsored, production-oriented programs such as section 236 may lead to the abandonment of basically well-constructed existing units and draw resources away from the conventional market. There is little evidence that these problems are of major import, particularly now with tight rental markets in most areas. Also, the continued existence of direct rental assistance programs to residents of existing units would seem to keep down the negative impact of a production program. And Wehner has concluded, after a market analysis, that subsidized units are generally in addition to the number of units the conventional market would have supplied.¹¹

It appears that in some areas per unit construction costs and rentals may be higher for section 236 units than for conventional market units. In the past, statistics which have supported this statement have become very controversial and have been criticized by responsible parties.¹² Doubtless this problem does exist in some areas because of prevailing wage payments, the complexities of Government processing generally, the need for environmental impact statements, etc. However, the greatly increased production of housing units for low- and moderate-income persons which the private market might not be able to provide would tend to justify these somewhat increased costs.

CONCLUSIONS AND RECOMMENDATIONS

The basic statutory and regulatory structure of the section 236 program is a viable way to produce new multifamily rental housing units. It has a flexibility and an ability to fine tune to certain housing needs which may be lacking in other housing programs. First, there is the built-in mortgage insurance mechanism while there is also a program with State and local agencies which does not involve mortgage insurance. Second, some projects could be designed from the outset with only the shallow interest subsidy while others could be designed with the deeper rental assistance payment (RAP) subsidy comparable to public housing levels. Either RAP or operating subsidies can be added later as needed. This is in contrast to section 8 which starts with the availability of a full subsidy for the units involved. Thus, these section 8 projects may not have the same opportunity for economic mix as section 236 projects. Whether or not section 8 marketing plans can overcome this initial stigma remains to be seen.

¹¹ Wehner, "Section 235 and 236, Eight Evaluative Studies" 29 (1973).

¹² Compare HUD, "Housing in the Seventies," 4/54-4/79 (1973) with Congressional Research Service, "Critique of Housing in the Seventies," 46-52 (Committee print, 1974).

The most productive changes in section 236 would be in the administration of the program. HUD should set up better procedures on project selection which should focus on sponsor and management selection and guidance. Particular care should be exercised in the selection of nonprofit sponsors following the patterns set up by recent section 202 selection procedures. HUD should also concern itself with the selection of the sites and the marketing plans for the project. It should be kept in mind by HUD personnel that section 236 was originally designed to benefit lower middle income groups rather than poverty level families. The future success of section 236 projects may depend as least partly on locating the projects in areas which are suitable for such middle income Americans and in directing marketing efforts toward this group. Thus, HUD should concentrate on screening the people and places involved rather than merely the economic terms of "the deal." HUD should also improve and speed up its procedures on estimating or reviewing items such as land valuation, operating costs, cost certification, income recertification and rent increase applications. HUD should also implement the operating subsidy plan provided by Congress in its 1974 amendments to the section 236 program.

The only statutory change which may be worth considering at the present time is a removal of the maximum tenant income limits and the substitution of a flat required payment of a certain percentage of income up to the fair market rent. Such a change would tend more equitably to distribute section 236 units in geographical areas with particularly high or low income or cost problems. It would also tend to provide a much greater economic mix of tenants in the projects.

Although section 236 is a viable housing supply program, it should be remembered that there will always be a need to couple supply-oriented interest subsidy and mortgage insurance programs with demand-oriented programs tied directly to the special needs of individual persons or families. Also, in order to reduce costs, there may always be a value in considering and continuing some of the direct loan, supply programs such as section 202 and public housing.

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EVALUATION OF THE HUD SECTION 235 SUBSIDIZED HOUSING PROGRAM

(By Philip N. Brownstein*)

Perhaps the most oft quoted statement appearing in housing literature is the goal set forth in the Housing Act of 1949 to provide "a decent home and suitable living environment for every American family." Pursuant to, and in partial fulfillment of this goal, Congress

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enacted the § 235 home ownership program as part of the Housing and Urban Development Act of 1968. That legislation not only reaffirmed the housing policy set forth by the 1949 Housing Act, but for the first time quantified the Nation's housing goals, and committed this Nation to the construction of 6 million units for low- and moderate-income families over the next 10 years. This goal was to be achieved through both rental and home ownership programs, and section 235 was to be the primary vehicle for the construction of subsidized dwellings for purchase by low- and moderate-income families.

Almost 9 years later, less than 500,000 mortgages on homes purchased by eligible families have been insured pursuant to section 235.¹ A program which began with high hopes and expectations has been engulfed in continuing controversy virtually from its inception. A continuing debate has evolved over the program's effectiveness: On the one hand, there are those who have criticized the program design as being ineffective and inefficient, and concluded that it is simply unworkable; on the other hand, there are those who say that the program has, can, and will work given proper administration, something, these critics contend, it has not received since its enactment. Those within HUD and the executive branch generally have been advocates of the first position, while many in Congress as well as public interest groups have tended to espouse the second. This paper will take account of both types of criticism, and will describe areas in both program design and administration where modifications and changes should occur.

BACKGROUND

In order to understand fully the goals and objectives of the section 235 program, it is important to remember the political climate and socioeconomic conditions affecting the Nation at the time of the program's enactment. The years 1967-68 were a time of turmoil and unrest in our Nation's cities. Not only was this country involved in a war in Vietnam, but it was also facing an internal crisis at home. The fear and unrest resulting from the riots and near riots in many of our metropolitan areas was reflected in the commonly voiced phrase of "save our cities."

The opportunity of home ownership for the poor was thought to be an appropriate response to the outcry and protest confronting the Nation. For those willing and able to accept the responsibility, home ownership was deemed a worthy aspiration, one which would afford qualified purchasers the hope and opportunity of entering the mainstream of American life. To such people, it was felt that home ownership could confer dignity, status, and the public recognition to which they had been previously deprived.

The concept was simple—to translate a demonstrated need into an effective demand. The subsidy becomes the economic equalizer to permit the less advantaged in our society to compete in the private market and bring an opportunity for home ownership within reach of those who otherwise would have found it beyond their means. In short, the purpose of the section 235 program was to offer qualified low- and

¹ As the companion paper on sec. 236 discusses, approximately 450,000 rental units for low- and moderate-income persons have been constructed during this time under sec. 236. The combined total thus falls far short of the intended goal.

moderate-income families the opportunity to enter both a market and a part of society from which they were otherwise excluded.

The precursor to the section 235 program was the section 221(h) program, enacted in 1966 under the sponsorship of Congresswoman Leonor Sullivan of Missouri. The program offered qualified low-income families the opportunity to obtain a 3-percent, 25-year mortgage with a minimum downpayment of \$200 for the purpose of rehabilitating and purchasing an existing dwelling. The program operated primarily in the St. Louis area and proved quite successful although on a very small and tightly monitored scale. However, it was phased out in favor of the section 235 program. Section 235 mortgages could include existing homes with or without rehabilitation but the main thrust of the program was directed at new construction. The interest subsidy approach was adopted instead of the below market interest rate concept primarily because the latter required the purchase of the mortgage by the Government, thereby creating a budgetary expenditure for the full mortgage amount at the time of purchase.

THE ORIGINAL PROGRAM

The section 235 program provides a subsidy spread out over the life of the mortgage, thereby ameliorating the budgetary impact created under section 221(h). The subsidy varies according to the income of the homeowner, the total mortgage amount, and the market rate of interest. The subsidy is made in the form of monthly payments by HUD to the lender on behalf of the homeowner. Under the program as originally enacted and administered, the subsidy amount was determined at the lesser of: (1) the difference between (a) the total monthly payment under the mortgage for principal, interest at the market rate, mortgage insurance premium (MIP), taxes, and hazard insurance, and (b) 20 percent of the mortgagor's adjusted monthly income; or (2) the difference between (a) the monthly payment to principal, interest at the market rate, and MIP and (b) the monthly payment to principal and interest that would be required at an interest rate of 1 percent, excluding MIP. In short, the subsidy enabled the homeowner to receive a mortgage carrying an effective interest rate of 1 percent, provided mortgage credit standards could be met and the homeowner was paying at least 20 percent of adjusted monthly income.

The maximum mortgage amounts are established by statute. In 1969, the maximum mortgage amount was set at \$18,000, which could be increased to \$21,000 for a family of five or more. These amounts could be increased by \$3,000 more for high cost areas, which are defined by HUD in sufficiently broad terms to include most urban areas. Mortgage limits were changed periodically and are now set at \$25,000 for a one-family residence, which may be increased to \$29,000 for a family of five or more purchasing a four-bedroom unit. The high cost adjustment is now set at \$4,000. Each unit insured by HUD under section 235 not only has to be less than the statutory mortgage limit, but also must satisfy HUD's valuation appraisal. The HUD valuation figure is determined based on replacement cost and the value of comparable units. In general, the same valuation procedures are involved as in other FHA home mortgage programs.

The mortgage term could theoretically run for 40 years, but in practice, HUD administratively restricted mortgages to a 30-year term except in extraordinary situations where a 35-year term was permitted. The mortgage insurance premium was established at 0.5 percent per annum.

Income limits under the section 235 program were originally set at 135 percent of the public housing income limits established for the particular area where the housing was located. In addition, up to 20 percent of the total amount of assistance payments could be made on behalf of higher-income families, i.e., those with incomes up to 90 percent of the income limits established under section 221(d)(3) BMIR. As of December 31, 1972, this translated into the following distribution: gross income of \$4,000 to \$5,000—10.2 percent; \$5,000 to \$6,000—23.7 percent; \$6,000 to \$7,000—26.4 percent; \$7,000 to \$8,000—19.3 percent; and \$8,000 to \$10,000—15.9 percent.²

Income limits were based on adjusted gross income. Among the authorized deductions from gross income were a \$300 deduction for each minor child who resided with the family, the income of these minors, a 5-percent deduction for payroll items, and a total exclusion for unusual or temporary income. Purchasers were required to certify their income on an annual basis, and the subsidy amount was adjusted accordingly. In addition to an income limitation, HUD also imposed an asset limitation whereby the assets of a family could not exceed \$2,000, plus \$500 for each dependent, plus 1 year's mortgage payment. Higher asset limitations were established for the elderly and the handicapped.

The minimum downpayment was set at \$200, provided the purchaser's annual income was no more than 135 percent of public housing limits. For families qualifying under the 90-percent-of-median income limitation, the downpayment was set at 3 percent of the estimated cost of acquisition. The downpayment amount could be applied towards closing costs and prepaid expenses incurred in connection with the closing.

Mortgages could be insured pursuant to section 235 covering either newly constructed, substantially rehabilitated, or existing housing, although a 30-percent limitation was established on the number of existing homes which could be insured. Any FHA-approved mortgagee could participate under the program and an additional servicing charge was authorized.

Although it was the clear intent of the program to provide counseling for eligible families, no appropriation was made under the initial legislation, and none was made by Congress until 1972, at which time Congress appropriated \$3,250,000. HUD set up a demonstration program with those funds, and did not request further appropriations in fiscal year 1973 or 1974.

The section 235 program was suspended pursuant to the moratorium on all subsidy programs announced in January, 1973, pending a departmental reevaluation and analysis of the program. The program was suspended allegedly because it was ineffective and inefficient and could not be made into a workable program. An analysis of the program was presented in the HUD study entitled "*Housing in the*

² Source: HUD, "Housing in the Seventies," pp. 4-47.

Seventies," which, not surprisingly, supported the conclusions previously advanced for the suspension of the program. The Department continued to honor outstanding commitments issued prior to the suspension, but refused to issue any new commitments under the program.

THE REVISED PROGRAM

On January 1, 1976, in response both to a pending suit to compel expenditure of impounded section 235 appropriations, as well as to the very depressed state of the homebuilding industry, HUD reactivated the section 235 program in a revised form. The new program differs in several major respects from the program as originally implemented.

First, the subsidy is not as great. The maximum assistance payments are now based on the difference between the market rate of interest and 5 percent, as opposed to the initial subsidy which enabled a homeowner to obtain a subsidy as deep as 1 percent. As before, however, the maximum subsidy is contingent upon the homeowner contributing at least 20 percent of adjusted monthly income.

Second, unlike the original program where the sales price could not exceed the maximum mortgage amount, a family is permitted to purchase a home for up to 120 percent of the maximum mortgage amount. In such an event, the purchaser must pay the excess to reduce the insured loan to the maximum mortgage amount permitted under the section 235 program. As before, all the homes purchased pursuant to section 235 must meet the FHA estimate of value.

The income level of the intended beneficiaries, as described by HUD, was revised upwards to the \$9,000 to \$11,000 income group. Income limits were increased so that a family of four qualifies as long as its adjusted annual income does not exceed 95 percent of the median income for the area at the time of initial occupancy.³ This amount is adjusted for smaller and larger families.

The downpayment requirements have been modified so that a purchaser under section 235 must now make the same downpayment as required under the nonsubsidized section 203 program, which is 3 percent of the first \$25,000 plus 10 percent of the balance of the acquisition costs over \$25,000. In addition to the foregoing sum, the purchaser must also pay closing costs.⁴

There is no asset limitation under the revised program. The mortgage term is fixed at a maximum of 30 years, and there are no extenuating circumstances under which HUD would permit a longer term. Moreover, the mortgage insurance premium has been raised to 0.7 percent from 0.5 percent.

Perhaps the most important change created by the new program, however, is the restrictive site eligibility requirements. HUD now specifies that no more than 40 percent of a subdivision comprised of more than 25 units is eligible to receive section 235 assistance. This effectively prohibits the development of large- or moderate-scale subdivisions all insured pursuant to section 235.

³ Income limits were initially set at 80 percent of median under the revised program, but were subsequently increased to 95 percent.

⁴ This requirement is less stringent than the originally announced revised program, which would have required a purchaser to contribute a minimum downpayment of 6 percent of the estimated cost of acquisition.

Counseling is now required, pursuant to the Housing and Community Development Act of 1974. To date, however, HUD has made only a limited amount of funds available under an experimental program, and generally a developer must provide the funds for such counseling.

Finally, the program is limited to new construction or substantially rehabilitated units. Existing units no longer are eligible.

GENERAL CONSIDERATIONS

A question to which there is considerable controversy is whether either the original and/or the reactivated section 235 program has or can satisfy the general objectives envisioned by the creation of the program. Put simply, has or can section 235 be a success, however that term is defined?

Before attempting to respond, it is necessary to review briefly certain assumptions and premises concerning the Government's role in assisting in the construction of low- and moderate-income housing. On one hand, while the 1968 legislation set forth certain goals, both in terms of policy and in number of units constructed, it must be recognized that it was never the intent for every income eligible family to participate in the section 235 program. Not every income eligible family is willing to accept the responsibilities of homeownership. Nor, for that matter, did Congress envision subsidies for all families who so desire. Only a finite amount of contract authority has been appropriated, which translates into enough subsidy for only a limited number of families. Congress was fully aware that not all eligible persons desiring homeownership would be able to receive such benefits. What the program provides, and Congress recognized, is a start in the right direction.

Moreover, the premise is accepted that the Government will continue to some degree or another to assist housing. There is no question that there is a continuing need for additional units of decent low- and moderate-income housing, and subsidies, in whatever form, play an important role in meeting this need.

Congress declared a goal of 6 million low and moderate units in 10 years. Plainly, that goal is, and was, unachievable without a substantially greater financial commitment on the part of the Federal Government. The goal was repudiated by the former Administration and it is much too early to see the direction the new Administration will take in meeting the Nation's housing needs. It is not the purpose of this paper to discuss the adequacy of specific appropriations, nor the relative priority of housing vis-a-vis other Federal expenditures. Suffice it to say that low- and moderate-income housing is important and must receive substantial moneys if the objective of the overdue promises of providing decent shelter ever is to be achieved. The level of appropriation will determine how equitable our housing policy is with respect to all qualified eligible individuals. Clearly, to the extent that some individuals within defined income eligibility limits receive a subsidy while others do not is an inequity which will remain and there is no reasonable expectation that this consequence is avoidable. Housing analysts both in and out of Congress obviously recognize this.

In light of the 3-year moratorium, there is no reasonable measure for evaluating the section 235 program in terms of equitable distribution or overall achievement of production goals. Rather, an evaluation must focus on the benefit to the recipient family, and the achievements (or lack thereof) made during the years when it was in operation. The remainder of this paper will focus primarily on the original section 235 program. The revised program has not had much of an effect since it was implemented; we will comment on its achievements and ways it can be improved at the end of the paper.

EVALUATION

There are three primary components which must be examined in order properly to evaluate the section 235 program—the number of families participating, the amount of subsidy involved, and the number of insurance claims made. It is useful to examine these figures both in terms of number of units and dollar amount, and existing units (including substantial rehabilitation) as opposed to new construction.

In certain respects, the achievements of the program have been substantial. Most importantly, the program has provided homeownership for approximately 475,000 families, most of which occurred in a 3-year period.⁵ These are families who otherwise would not have been able to achieve homeownership. The vast majority have proved successful.

Yet, as of the first quarter of 1976, 16.87 percent of the section 235 mortgages resulted in insurance claims.⁶ Unquestionably, this figure is high, and would be considered unsatisfactory were the program dealing with sophisticated, credit-worthy families. But it does not. It is not fair or appropriate to compare this program to nonsubsidized programs. The purpose and objectives of this program are sui generis. The question to be asked is not whether the default rate is too high, but whether a success rate of 83.13 percent is too low. Without fully coming to grips with that difficult question, it is clear that the success rate can be substantially increased with certain improvements made in the program, as discussed below. Also, it is important to point out that, although the exact breakdown was not available, the 16.87 percent insurance claim statistic includes both foreclosures and assignments. Where the mortgage has been assigned to HUD, there is still the possibility of working out the financial problems and continuing ownership in the same individual or family.

Another important statistic to recognize is the amount of subsidy received by families. The subsidy amount fluctuates depending on income, and the more income a family earns, the less the subsidy payment will be. In this regard, the program has been particularly impressive. Of the 368,248 families still participating in the program, approximately 136,019 (or 37 percent) have earned their way off subsidy completely. Moreover, of the approximately \$348 million of total annual reserved contract authority, only \$155 million was expended for calendar year ending September 30, 1976. While the precise data

⁵ Source: Data furnished by the Library of Congress. A breakdown by year and by type of unit insured is set forth in appendix A.

⁶ Source: Data furnished by Library of Congress. A breakdown by year showing the number of insurance claims, the cumulative percentage claims, and the number of insured units remaining in force is set forth in appendix B.

are unavailable, we have been advised that for those still receiving subsidy, the average amount received per family has declined substantially from the amount initially received.⁷

Aside from the program's cost, perhaps the major focus of criticism has centered on the abuses which have pushed section 235 on to the front pages of the newspapers. Exemplifying the problem was an article appearing in the December 15, 1975, issue of *Barron's* at the time HUD announced the implementation of the revised program. The article was entitled "Painting Over the Cracks: Section 235, the 'National Housing Scandal,' is Back in Business." The *Barron's* article, as well as others, recounted the scandal and fraud which it alleged initially plagued the section 235 program, particularly with respect to existing houses. A commonly perceived scenario was described as follows: A developer would purchase several homes in poor condition on which cosmetic repairs would be made. An inflated estimate of the property value would then be obtained from HUD, at which time the home would be sold to an unsuspecting, unsophisticated purchaser. Shortly after the homeowner moved in, it became evident the house had major faults making it virtually unlivable. This sets off a chain reaction: First, as the homeowner has no money to make repairs, the house deteriorates further. Eventually, as a result of the substandard conditions, the homeowner decides to abandon the home; the lender then transfers the vacant home to HUD. Concurrently, the home is vandalized, and remains vacant in its blighted condition for numerous months while remaining in HUD inventory. Meanwhile, other homes on the block begin to undergo a similar process, whereby a snowballing effect takes hold and other homes are abandoned and transferred to HUD, and the vicious cycle continues.

While the abuses described above have occurred to some degree in connection with the section 235 program, one must recognize that much of this occurred under the nonsubsidized programs, particularly section 221(d)(2). However, critics tend to lump the programs together and make section 235 the scapegoat. In light of these types of abuses, many have advocated abolishing the section 235 program for existing housing while continuing the program for new construction, as is the case under the revised program. Despite the apparently greater problems confronting existing housing, however, the only available statistics show the rate of default has been fairly similar for existing and new construction. As of June 1974 (the latest date for which data are available), the default rate (including both foreclosures and assignments) for existing homes was approximately 11.9 percent, while new construction was 10.5 percent.⁸

It is surprising the difference is so small. It perhaps can be explained by the large number of defaults resulting from the snowballing effect which can occur in large subdivisions comprised almost entirely of units insured under section 235. In such subdivisions, HUD has allowed a small number of vacant units to remain in blighted condition for long periods of time, which tends to lower neighboring property values, thereby causing other homeowners to vacate, and the cycle is

⁷ Source: HUD's Advanced Statistical Analysis and Computer Applications Branch, MIS Division, and HUD's Program Support Staff, Office of Insured and Direct Loans.

⁸ Source: HUD's Advanced Statistical Analysis and Computer Applications Branch, MIS Division, Housing.

repeated. HUD has made no provision for an owner to transfer the right to subsidy to another section 235 eligible if he wants or has to sell and this has caused defaults. So, in many instances, up to 50 percent of all homes in such subdivisions are acquired by HUD. Moreover, once a property is acquired by HUD, the turnaround time can run upward of 1½ years. In such instances, HUD itself has been a contributing factor to the section 235 failure rate.

Another problem concerns the inability of the program to provide additional subsidy to meet increases in such items as taxes and insurance where families are already receiving the maximum subsidy. It must be remembered that the subsidy amount is calculated on the basis of the lower of two formulas: The first is based on the homeowner paying 20 percent of income, while the second is based on a mortgage bearing a 1-percent interest rate. Those receiving subsidy based on the second formula are receiving the maximum allowable subsidy. These families are generally poorer than those receiving subsidy under the first formula; often they pay 30 percent to 40 percent of their income for housing. Yet they are being forced to pay additional amounts to cover increases associated with rising housing costs, and this too has been a contributing factor in causing insurance claims.

RECOMMENDATIONS

The goals and objectives enunciated in 1968 are equally valid today and the section 235 program remains a valid and desirable means of achieving those goals. To undertake this commitment is an expensive proposition. Part of the criticism leveled at the program is no doubt a function of this fact. Yet, for the program to be successful, housing must be constructed, which necessitates further, and greater budgetary expenditures in addition to the \$1.2 billion in subsidiary moneys already spent.⁹

The program concept is demonstrably workable, but certain changes and improvements should be made in order to increase the likelihood of success. A failure rate of substantially less than current levels should be achievable. The average loss to HUD on each insurance claim has been approximately \$5,945.¹⁰ This money can be used far more effectively in the form of subsidy payments. On the other hand, an extremely low default rate would tend to indicate a certain segment of the intended beneficiary class is not being served. The population segment being served must be considered to be in the high risk category. There must be willingness to accept a higher rate of default in the short run, if the desired results are to be obtained in the long run.

Probably the most important change in the program is to improve the screening process to determine those families which possess the commitment and desire to achieve home ownership, and to provide counseling to those so chosen. There are many more income qualified families than subsidized homes available, and thus careful screening can be accomplished and still maintain the objectives of the program.

⁹ Source: HUD, Office of Finance and Accounting, Financial Analysis and Investment Division, "Summary of Mortgage Insurance Operations and Contract Authority," Sept. 30, 1976, p. 20 (hereafter "Summary of Mortgage Insurance").

¹⁰ Source: "Summary of Mortgage Insurance," p. 12.

Once a family is selected, it is equally imperative that they be counseled and instructed in what is necessary to maintain a household. It is simply not enough to provide individuals with keys to a house, a mortgage payment book, and then walk away. To those who have never owned a home, it can come as quite a shock when a repair has to be made and there is no one who automatically comes to perform the repair. Moreover, an uncounseled homeowner is easy prey for salesmen selling everything from fire alarms to picket fences, especially when the cost is described in terms of pennies a day.

The 1968 legislation recognizes counseling as an essential element in achieving a successful home ownership program. Section 101 of that act authorizes the Secretary to provide budget, debt management, and related counseling service to mortgagors under the section 235 program. Unfortunately, these programs were not funded at all initially, and were never funded adequately. The counseling requirement was reaffirmed in the Housing and Community Development Act of 1974, which similarly required that counseling be furnished. HUD is now involved with an experimental program to test the concept. At the present time, however, the developer must pay all costs. For counseling to work, however, both HUD and the community must become involved. A family must be counseled by people they respect and people they will listen to. Not only must families be counseled prior to moving in, but counseling must continue for a period after the family has moved in.

Another particularly important improvement in the program would be to prevent a default which might be triggered where some major item of repair is required, and the homeowner lacks the funds necessary to make such repair. This problem is particularly important in the case of existing construction, but also applies to new construction as well. It is senseless to screen a family carefully, provide guidance and counseling needed to maintain a home, have them meet all of their mortgage payments in timely fashion, and then have the mortgage go into default simply because there is no source of funds to repair a leaky roof. Particularly with respect to existing housing, part of this problem can be solved by HUD making a structural inspection of the home prior to purchase. In addition, HUD should consult with the purchaser during the initial counseling sessions to discuss what will have to be done in the event such a defect is found. Most importantly, however, there should be a mechanism under which HUD could or should make funds available on lenient terms to pay for such repairs. This will require legislation but it is a needed ingredient in making the program successful. It may be true that such a loan could not be supported on a valuation basis. However, if such a loan is not made, the alternative is for HUD to make a payment under its mortgage insurance contract. HUD simply must take the risk that the homeowner will continue to live in and maintain the home, even though the homeowner may have a "negative" equity, that is, the home may be mortgaged for more than its fair market value.

Another area which could be improved is the means by which HUD disposes of properties as inadequate property maintenance and unduly delayed disposition directly relates to future defaults. It is simply too costly for there to be a turnaround time in HUD inven-

tory of 1 to 2 years. Defaults resulting from the "snowballing" effect in large subdivisions can perhaps be ameliorated by aggressive efforts in the property disposition program. The snowballing effect can be particularly troublesome in subdivisions comprised virtually entirely of § 235 units.

HUD, under its revised program, has restricted subdivisions comprised of all section 235 units in an attempt to prevent the consequence resulting from heavy concentrations of section 235 units. This limitation is unduly restrictive and often makes the program unworkable from a developer/builder's point of view. The ability to construct hundreds of thousands of new dwellings in a 3-year period was a major accomplishment under the original program. The program was made attractive, and builders responded. If on the other hand, builders do not consider the program sufficient to justify the economic risk, few units will be constructed.

Limitations on the number or percentage of units in a subdivision may be workable if the restriction is sufficiently flexible to attract participation and if it is possible to market some number of unsubsidized units. However, such limitations may not be necessary at all, if income limits for the § 235 program are removed and the program opened up to all who desire to participate under certain eligibility criteria which would be self-regulating. There could be cost limits on the house, maximum mortgage amounts, and a requirement that each owner pay a specific percentage of family income (similar to the present formula) up to full debt service on the mortgage. This would have the effect of reducing the amount of subsidy paid to higher-income families. The higher-income family would receive less subsidy; the poorer family would receive more. The effect, however, would be to create some economic mix in the subdivision, thereby avoiding a concentration of the lowest income eligible families.

Alternatively, rather than placing income limits on families, one could establish percentage limits based on the two alternative formula subsidies. The subsidy is determined as the lesser of (1) the difference between the mortgage payment and 20 percent of income, or (2) the difference between the mortgage payment computed at the market rate of interest and 1 percent. Families receiving subsidy pursuant to "formula one" are relatively higher income families, for whom the subsidy will increase if their income falls or taxes or insurance payments increase. "Formula two" families are already receiving the maximum amount of subsidy, and must absorb any such increases themselves. By initially restricting the number of families which receive subsidy pursuant to these formulas, an income mix can be created in the subdivision.

Moreover, the subsidy amount should be increased so that in certain circumstances, the subsidy could be based on a zero-percent interest rate, and also cover taxes and insurance. The deeper subsidy would be appropriate, for example, in those instances where the homeowner would be forced to pay in excess of 30 percent of adjusted monthly income.

In order to create a more equitable geographic distribution of dwellings insured under § 235, an adjustment of maximum costs and mortgage limits should also be considered depending on costs in each

locality, in a manner similar to the way income limits are now imposed. The original program had a far greater number of units built in the South and West, and fewer in the Northeast, and Middle West, in part because of the higher costs involved in building in the latter areas.

Another valuable change in the administration of the program would be for HUD to set up an easy system under which a § 235 homeowner could transfer the house to another § 235 eligible. The new owner should be able to receive whatever level of subsidy is appropriate for his/her family income even if it is greater than that received by the original owner. This would cut down on the number of homes which are simply abandoned when § 235 owner must move and is unable to find market rate buyers.

One of the charges commonly leveled against the program is that it is inequitable—i.e., similarly situated families are not treated equally. Short of a full income maintenance approach to this problem, which would address not only housing subsidies but all subsidy and welfare payments, true equity is not feasible. However, one improvement which might be considered to create more equity in the § 235 program would be to impose some form of recapture on the amount of the subsidy paid on behalf of the homeowner upon the resale of the home. The funds so recaptured could be used to subsidize additional homes, thereby maximizing the number of families given the opportunity to participate in the program. This approach seems particularly reasonable in view of today's inflationary pressures generally, and on real estate in particular despite the problems which would be involved in administration. Mechanically, perhaps the simplest means is to place a second mortgage on the property in the amount of the subsidy payments. The lien would increase as subsidy payments are actually made, in the same way that the lien increases on a construction loan. The second mortgage would not require making any payments prior to resale, but would impose a lien against the property to the extent of the subsidy paid at the time the property is sold. If the entire subsidy is not recaptured, the homeowner should not be liable for any deficiency.

An alternative means of recapture would be to revise the § 235 program so that instead of placing one mortgage on the property, on which HUD and the homeowner each make partial payments, two mortgages would be established. The first mortgage would be in an amount which the homeowner could support without subsidy in the private market; the second mortgage would be the additional amount needed by the homeowner to purchase the property, and in effect would be the "subsidy" payment. This approach is being implemented on an experimental basis in Dade County, Florida, and the results bear watching. It should be noted that one problem which may exist with respect to this approach is that it requires full budget expenditure in the first year, and may thus prove unduly burdensome from a budgetary standpoint.

COMMENTS ON THE REVISED PROGRAM

The revised program has not achieved its desired objectives. Primary evidence of this is the minimal number of units insured to

date—through December 31, 1976, the total number was only 1,167 units.¹¹

Moreover, as the subsidy is not as deep as under the original section 235 program (it is based on the difference between the market interest rate and 5 percent, as opposed to 1 percent), it thereby eliminates one of the major purposes for implementing the program in the first place. The revised program, in light of the lesser subsidy, is targeted by HUD at the \$9,000 to \$11,000 income group, as opposed to an income group of \$2,000 to \$4,000 less under the original program. To the extent that the lower-income groups are foreclosed due to the participation of the higher-income eligibles, the program loses much of the initial incentive for being.

The percentage limitations placed on the number of subsidized units which can be insured in a subdivision is perhaps the major factor which accounts for the revised program's lack of production. The restriction imposes risks on a builder which many believe are excessive. One of the more attractive parts of the original program was that the builder was virtually assured of a guaranteed market, and could plan and build accordingly. Such assurances are not available to a builder under today's program. It is, of course, recognized that some of the failures were also caused by large concentrations of section 235 owners in sizable subdivisions.

Other factors which account for the program's lack of results include the higher downpayment requirements and mortgage limits which are too low in certain areas of the country. The downpayment requirement has been reduced somewhat, but still exceeds the amount which a large segment of the intended section 235 market is able to meet. As discussed above, mortgage limits should be determined on an area-by-area basis as is now done for income limits, and serious consideration should be given to doing away with income limits entirely.

Finally, the new program increases the annual MIP payment from 0.5 percent to 0.7 percent, apparently in an attempt to make the special risk insurance fund actuarially sound. The change of MIP was in the wrong direction for two reasons. First, we are dealing with high risk families, which makes it extremely difficult to forecast what MIP payment will produce an actuarially sound return. Second, and more importantly, MIP is merely a payment from HUD to itself. Instead of raising the payment, it would perhaps have been more fitting to have eliminated it entirely.

Reinstating the section 235 program, after the 3-year suspension, was a step in the right direction. But the program as revised must be further modified if it is to achieve any real result, and if it is to comport with the original objectives set forth in the 1968 legislation.

CONCLUSION

The section 235 program offers a viable means of providing assistance to low- and moderate-income families who desire to achieve the goal of home ownership. It has, and can continue, to assist hundreds of thousands of people in reaching this goal. The number of

¹¹ Source: HUD's Single Family Mortgage Insurance Division, Office of Insured and Direct Loans.

people going off of subsidy, or receiving reduced subsidy, is particularly impressive. While the default rate has been higher than under some nonsubsidized programs, section 235 should really be measured in terms of its achievements recognizing the nature of the program and initial weaknesses in administration. Moreover, with certain administrative changes in the program, the default rate can be reduced.

There are certain changes which should be made in the program, particularly with respect to the screening and counseling to families, providing money for repairs, revising HUD's property maintenance and disposition program, modifying the subsidy formula to provide additional amounts in certain instances, and adjusting mortgage limits on an area basis, and easing transferability requirements. The program, however, is workable.

The section 235 program can be used as a vehicle both for new construction as well as for existing housing (including substantial rehabilitation). While new construction is easier to administer and is less subject to abuse, some amount of existing housing could be equally well-administered given the time and effort, particularly in the inspection and valuation processing.

In sum, the section 235 program is an appropriate response to the demands of low- and moderate-income families to be brought into the mainstream of American life. The goals and objectives behind the original legislation are equally applicable today, and the program can be made into a truly viable vehicle for achieving these ends.

EXHIBIT A
UNITS INSURED UNDER THE ORIGINAL SEC. 235 PROGRAM

Year	New construction	Existing	Total
1968.....	4	35	39
1969.....	11,083	14,647	25,730
1970.....	78,412	27,212	105,624
1971.....	129,731	14,881	144,612
1972.....	100,059	19,465	119,524
1973.....	44,701	13,333	58,034
1974.....	4,882	9,237	14,119
1975.....	797	5,115	5,912
Total.....	369,669	103,925	473,594

EXHIBIT B

Year	Default termina- tions insurance claims	Cumulative percentage	Insurance in force
1969.....	41	0.16	25,571
1970.....	1,171	.93	129,608
1971.....	6,849	2.93	266,807
1972.....	16,637	6.26	368,313
1973.....	18,931	9.65	403,077
1974.....	20,435	13.75	390,163
1975.....	13,250	16.39	373,390
1976 (1st quarter).....	2,287	16.87	368,248
Total.....	79,601		

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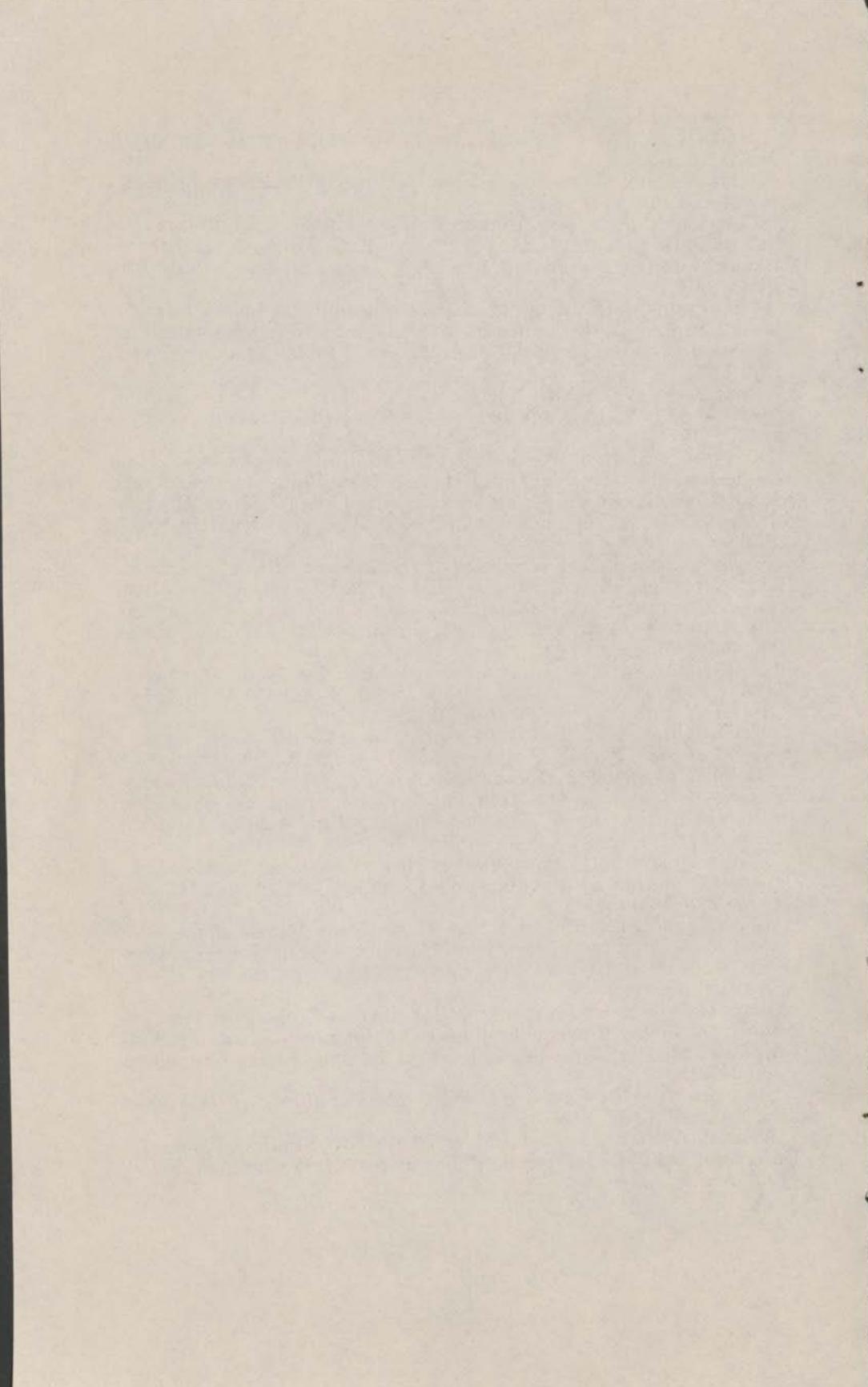
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[5084-1 February 24, 1977]

HOUSING LOW-INCOME FAMILIES

A SUMMARY OF SELECTED RESEARCH PRODUCTS

(Compiled and Summarized by David B. Carlson—Afterword by
Morton L. Isler)

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AFTERWORD.

I. INTRODUCTION

THE HOUSING OUTLOOK FOR LOW-INCOME, URBAN FAMILIES

In the absence of major public interventions, the housing situation for low-income families in the Nation's cities will worsen appreciably during the next 5 years. Although rates of change will vary in different types of urban housing markets, in general these are the trends foreseen as a result of the Institute's analysis:

Incomes will rise more slowly throughout the 1970's than was the case in the 1960's. The real increase in household income will be only about 17 percent for this decade, compared to 26 percent for the previous decade.

The cost of housing are rising twice as fast in the 1970's as in the 1960's and are outrunning cost increases reflected in the composite consumer price index. Operating costs associated with housing (exempli gratia, utilities, labor, and taxes) will continue to increase faster than capital inputs.

As a result of the two trends noted above, families will find themselves paying a higher percentage of their incomes for housing during the 1970's than they did in the two previous decades. Lower income families will experience the most severe increase in the percentage of income paid for housing, an estimated increase of 35 to 40 percent during the decade.

Although metropolitan growth will slow down, there will be a continuing increase in the number of minority households in cities, and a coincident decline in the number of nonminority households.

The trend to a higher proportion of households headed by the elderly, single individuals, and women will continue. Because these households traditionally spend a higher percentage of their incomes for housing expenses, this shift alone constitutes an important factor in the overall increase in housing expense-to-income ratios for the remainder of the decade.

These trends have been delineated principally through the use of the Institute's housing market model and the DYNASIM model to make projections of household incomes (see appendices of UI-235-1).¹ The trends themselves generate a number of implications for housing policy, among the most important of which are the following:

For the remainder of the decade, and perhaps longer, there will be a lessening of demand for larger units and a coincident growing demand for smaller units, in the Nation as a whole. This is due both to the shifts in household composition toward smaller households and the deterioration in growth of real income relative to housing costs;

The percentage of income that lower-income families pay for rent will rise sharply, relative to increases for other groups, because of increased competition for smaller units resulting from shifts in household composition and the reduced rate of growth in real incomes;

Although the situation will vary in different market areas, improvements in housing quality, as measured by the quantity of

¹ See listing of referenced Urban Institute studies at end of volume.

housing services consumed, will not be so great as was the case in the 1950-70 period;

There is considerable evidence that unless they are willing to devote larger shares of their incomes to housing expense, minority families will suffer particularly from the slowdown in the increase in quality. By 1980, there could be more minority families living in substandard housing than there were in 1970, largely because minorities are so heavily represented in those income groups that will be most affected by the trends described;

Although conditions will vary considerably depending upon what is happening in each local market, there will probably be a sharp reduction in the abandonment of housing and low vacancy rates.

THE NEED TO SHAPE PROGRAMS TO FIT DIVERSE HOUSING MARKETS

The Institute's market model provides an opportunity to analyze changes in the factors of supply and demand for different metropolitan market situations. This permits the taking into account of the very wide diversity to be found in these markets. It also makes it possible to weigh long-term, indirect effects of given program actions. For instance, the character of the housing stock, its age and condition, varies greatly from one market to another. Demand factors, such as income and household composition, are also important variants. And, perhaps most important, differing rates of growth and changes in household incomes cause different responses to public interventions. For instance, two cities that are in the same general size category, Milwaukee and San Jose, experienced very different growth conditions during the 1960's, especially in the lower income group. San Jose grew by 66 percent overall and the number of low- and moderate-income families increased by 25 percent. Milwaukee, however, grew by only 5 percent overall and its number of low-income families actually declined by 17 percent during the decade. Obviously the two cities must be expected to respond in different ways to similar sets of Federal interventions (see table at end of introduction).

The dynamic forces of supply and demand ebb and flow in varying degrees, making the imposition of a single Federal program approach an infeasible option. A more workable formula would seem to be one which offers localities a mix of subsidies from which they can devise a comprehensive program fitting their perceived needs. Federal oversight would still be an essential ingredient, to insure that national goals are being vigorously pursued on the whole, and that program costs are under control. Recent legislation, namely the section 8 program, shifts responsibility to some degree to local housing authorities to select their own mix of new construction, rehabilitation, and existing leased units. It still remains to be seen whether or not local officials can comprehend and act upon the forces set in motion by more flexible subsidy programs. There is still limited capability in local government to understand the implications of the many relatively subtle Federal interventions (for example, various income transfers) that impact their areas, and there should be a strengthened effort made to assist local governments in this regard.

STRENGTHENING LOCAL MANAGEMENT CAPABILITY

Much of the Institute's work has been directed at providing a basis for local units of government to strengthen their housing capabilities in the management of the housing stock. Because of the scarcity of social science research in housing management, the Institute began its first efforts by developing a definition of "good" housing management. The criteria used for this definition included measures of tenant and management staff satisfaction as well as more traditional measures of stock condition, rent delinquency, vacancy rates, and unit turnover. In some cases, financial measures were also used. Measures of management practice, organizational structure, tenant involvement, and operating conditions were developed and related to the criterion measures. To date, the Institute has studied over 500 HUD-subsidized projects, interviewing over 20,000 residents, managers, and homeowners.

An example of this work, using information collected during 1974 at 40 large housing authorities, involves analyses comparing performance levels, operating conditions, and management practices at 171 projects. Data from these surveys were then compared to similar measures taken at the same projects in 1973, enabling Institute researchers to study for the first time the impact of management changes on performance levels. Earlier analyses of housing management compared different housing projects at a single point in time. Using the forementioned criteria, projects were divided into high- or low-performance groups and the management characteristics that distinguished high-performance projects were identified. The well-performing projects were characterized as having high degrees of management strictness, rapid and appropriate responsiveness to problems, positive tenant-management relations, and an emphasis upon decisionmaking at the project site.

FEDERAL POLICIES FOR IMPROVING HOUSING CONDITIONS OF
THE URBAN POOR

During the 1960's, the Federal Government attempted a variety of direct program approaches to provide better housing for lower-income families. The emphasis was upon new construction subsidies, in the main, and the result was a record number of subsidized units built and a considerable upgrading of housing in many urban markets. But only a small fraction of families eligible were directly served by the programs. And in some markets characterized by a surplus of lower quality units, the subsidies proved a relatively expensive way to provide minimum standard housing compared to upgrading the existing stock.

Most federal interventions into the housing condition of the urban poor come in the form of direct cash payments (that is, welfare, veterans' benefits) or, more recently, revenue sharing or block grants for various aspects of community development. As small as these amounts seem to be, and as inadequate as they have been to date, they are nevertheless of magnitudes many times larger than the total of the "housing programs" of the past 40 years. Largely because of dissatisfaction with the housing programs of the 1960's, other program approaches have been proposed. One is an expanded welfare program,

with no earmarking for housing. Three benefits are cited for this approach: (1) it is simpler to administer, and (2) less likely to create unintended and undesirable side effects such as price inflation in specific market situations. Finally, recipients would have more freedom in choosing what to buy than they would if they got earmarked payments or were provided with subsidized units. On the other hand, the cost of a general income transfer program would be relatively high, possibly double or triple that of a housing allowance, and would not draw support from those groups that traditionally desire housing subsidies, and who feel that housing is a "merit good."

Either an expanded welfare program or a housing allowance meets the need for housing aid to the poor, but can have the adverse effect of raising the price of housing without a commensurate increase in quality. One answer to the problems posed is to permit a mix of housing subsidies aimed at the urban poor, which would not only upgrade the quality of their accommodations at relatively lower prices (or at least prices commensurate with the upgrading) but also negate most of the adverse side effects. The Institute, using the market model, has developed several simulations combining a housing allowance with subsidies for either rehabilitation or new construction, and has compared the three approaches. The results indicate that:

In markets which would experience sizable allowance-induced price increases, such increases could be mitigated with either a new construction subsidy or a properly targeted rehabilitation subsidy. The combination of new construction subsidies with allowances was most effective in mitigating any redistribution of benefits from participants to landlords;

The combination of an allowance with a large-scale rehabilitation subsidy (all low-quality units eligible for aid) was as effective in increasing the housing consumption of low-income households (that is, raising the quality of their housing) as a larger allowance program alone. The combination of an allowance with new construction achieved a smaller increase in consumption for the same size population;

In market situations which experience only modest price increases because of allowances, neither new construction nor rehabilitation subsidies generated significant gains in housing consumption above those attributable to the allowance alone.

A broader understanding than can be provided through simulation alone is being developed through the national housing allowance experiment, which was initiated in 1970. The experiment was designed to analyze effects of an allowance on participants and housing markets, as well as to provide insights on various models of administration via different types of agencies.

Work to date has indicated the following:

EHAP has attracted more than 18,500 lower-income families to participate in the program, and to upgrade, in varying degrees, the quality of their housing, or reduce the proportion of their incomes paid for rent.

Evidence to date in Green Bay and South Bend suggests that there are no marketwide effects, at least in the short run (28 months in Green Bay and 19 months in South Bend) for either

renters or homeowners. That is, there is no inflation in housing prices induced by the allowance itself, beyond those price increases that are commensurate with the higher quality of the units. So far, about 40 percent of all eligible families have enrolled in Green Bay, and about one-third of the eligibles in South Bend.

THE CRS ASSIGNMENT

As expressed in the work statement for this contract, CRS is particularly interested in those aspects of the Institute's work regarding "Government responses to the housing needs of low-income households." The work that follows treats, therefore, with Institute findings regarding four basic program areas: The experimental housing allowance, conventional public housing, section 23, and section 8. The latter two program elements have been combined, both because they are so similar in content, and also because the Institute's analysis regarding section 8 has just been recently initiated. There is also a special section regarding the Institute's work with the market model, much of which is still in its early stages, but which offers some insight into the complexities of the market conditions affecting lower-income families.

Table 1
Indicators of Metropolitan Housing Market Diversity
(data for 1970 unless otherwise noted)

Indicator	Population size category*							
	Over 7 Million		1-2 Million		500,000-1 Million		50,000-500,000	
	Maximum Value	Minimum Value	Maximum Value	Minimum Value	Maximum Value	Minimum Value	Maximum Value	Minimum Value
A. Special Structures								
1. Population	11,571 New York	2,070 Baltimore	1,284 Houston	1,064 San Jose	916 Columbus, O.	519 Jacksonville	413 Fresno	65 Midland
2. Population Density (persons per sq. mile)	5,419 New York	788 Pittsburgh	2,654 Newark	316 Dallas	691 Jacksonville	324 Sacramento	1,076 New Bedford	69 Fresno
3. Percent of dwellings in one unit structures	73 Philadelphia	28 New York	74 Houston	47 Newark	81 Youngstown-Warren	62 Syracuse	86 Midland	48 New Bedford
4. Percent of population black	24 Baltimore	4 Boston	19 Houston	2 San Jose	25 Jacksonville	4 Syracuse	28 Augusta, Ga.	1 Lowell
B. Housing Demand								
5. Median family income (\$)	12,112 Detroit	9,729 Pittsburgh	12,453 San Jose	10,129 San Diego	11,965 Rochester, N.Y.	7,473 Columbus, O.	10,934 Cincinnati	8,199 Knoxville
6. Percent of Households in Poverty	9.3 New York	6.1 Boston	9.8 Houston	4.6 Minneapolis-St. Paul	5.2 ^b Jacksonville	17.4 Rochester, N.Y.	17.4 El Paso	8.1 ^b Des Moines
7. Percent of dwellings Over-occupied	72 Detroit	37 New York	70 Denver	53 Newark	75 Youngstown-Warren	39 Columbus, O.	74 Midland	54 New Bedford
8. Percent Change in Families 1960-70	22.2 Los Angeles	-0.1 Pittsburgh	65.6 San Jose	4.7 Milwaukee	27.8 Sacramento	4.4 Toledo	40.7 Cincinnati	0.0 Fla.
9. Percent Change in low-moderate income families, 1960-70 ^c	3.1 Los Angeles-Orange	-23.5 Detroit	24.7 San Jose	-17.0 Milwaukee	27.9 Jacksonville	-18.1 Youngstown-Warren	15.3 Cincinnati	-17.2 Des Moines
10. Percent of Population 65 yrs. & over	11 Boston	8 Baltimore	10 Newark	10 Houston	10 Rochester, N.Y.	7 Salt Lake	13 New Bedford	5 Midland
11. Mean Population Per Household	3.3 ^b Baltimore	2.9 ^b Los Angeles	3.3 ^b San Jose	3.1 Denver	3.3 Salt Lake	3.1 Sacramento	3.7 El Paso	3.1 Knoxville
C. Housing Stock								
12. Percent of structures built in 1960-70	25 San Francisco-Oakland	14 Boston	49 San Jose	17 Newark	36 Sacramento	19 ^b Toledo	47 Cincinnati	10 New Bedford
13. Percent of structures built prior to 1950	72 Boston	45 Los Angeles-Orange	64 Newark	21 San Jose	62 Toledo	31 Sacramento	78 New Bedford	22 Midland
14. Rental Vacancy Rate	7.9 Detroit	2.3 New York	13.2 Seattle-Everett	2.9 Newark	11.5 Jacksonville	4.6 Salt Lake	13.5 Midland	3.2 New Bedford
15. "Fair Market Rent" of 1 bedroom apartment, 1975 ^d	241 New York	178 Pittsburgh	231 San Jose	170 Houston	210 Rochester, N.Y.	160 Jacksonville	216 Lowell	127 Savannah-Fort Arthur

*The areas included in each group are: (1) largest - New York, Los Angeles, Chicago, Philadelphia, Detroit, San Francisco-Oakland, Boston, Pittsburgh, Baltimore; (2) 2nd - Houston, Newark, Dallas, Seattle-Everett, Milwaukee, San Diego, Denver, Indianapolis, San Jose, Minneapolis-St. Paul; (3) 3rd - Columbus (Ohio), Rochester (N.Y.), Sacramento, Toledo, Syracuse, Salt Lake, Youngstown-Warren, Jacksonville; (4) smallest - Fresno, Knoxville, El Paso, Savannah-Fort Arthur, Des Moines, Augusta, Lowell, Knoxville, Lubbock, New Bedford, Ogden, Gainesville, Midland

^bMore than one city with the maximum or minimum value

^cDefined as 1970 households with incomes of \$10,000 or less compared to 1960 households with incomes of \$7,000 or less.

^dThe Fair Market Rent is the market rent defined by the Department of Housing and Urban Development for units to be leased under the Section 8 housing program. Such rents are defined for various sized units, all of which must meet certain quality standards.

Sources: U.S. Bureau of the Census, *County and City Data Book*, 1972 (Washington, D.C.: U.S. Government Printing Office, 1973).

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II. THE URBAN INSTITUTE'S HOUSING MARKET MODEL

A DESCRIPTION OF THE MODEL

The market model offers an opportunity to simulate changes in housing quality and housing location over a 10-year period in different types of metropolitan markets. The model focuses particularly upon two areas of complexity where information is most lacking: The differences in policy effects among metropolitan areas and the differences between direct effects (e.g., new construction and the long run) and indirect effects (e.g., changes in the composition of the housing stock). Further, the model is designed to reflect the effects of governmental or private actions on the housing situation of households differentiated

by race, income or family type (e.g., nonelderly families versus single individuals).

The model has already provided valuable insights into the complex problem of providing better quality housing at lower prices to poor, urban families. Perhaps the key point that has emerged from the analysis is that the magnitude and type of indirect effects caused by housing policy depend upon the conditions in any particular market at the time of implementation. Quite clearly the direct effects can be similarly dependent, as when no developers wish to participate in a building program for low-income households because even with a subsidy new units will not be competitive with existing units carrying a price discount. For national policy to apply the same housing program to all urban markets is a mistake because of the vast differences in the indirect effects produced by any major Government program.

The model is calibrated to individual metropolitan areas and its predictions are, therefore, specific for diverse market situations (e.g., high versus slow growth; a relatively high versus a low percentage of minority households). The model divides each metropolitan area into four to six zones, each so defined as to maximize each zone's homogeneity of base year housing quality, travel times of workers, and the socioeconomic mix of households. Model dwellings and model households in each zone represent actual incomes, racial characteristics of households, and the quantity of housing services provided by the dwellings in each area (see figure 1). The major outcomes of the model are the prices and quantities of housing services prevailing at the end of a decade, the number of new units added to and number of units removed from the stock during the period, and the location of households among zones. (See "Web of Urban Housing," UI No. 12700.)

After applying the model to six metropolitan areas for the 1960-70 period, four prototypical metropolitan situations were designed, reflecting the actual market experience for those areas during the decade. The hypothetical cities are representative of the entire population of the Nation's metropolitan areas, and the differences among them are relatively small in number and precisely identifiable, making it possible to generalize about how those differences in conditions influence the effects of housing policies or trends in key market factors. And, because the model areas are based upon national data, it is possible to use various national projections made by the Census Bureau and others in estimating future values of model inputs. (Characteristics of the four model areas are shown in table 2.) The prototypical cities exhibit sharp diversity in the two factors which have important effects on the final situation of households—racial composition and the rate of growth in the number of households. The model incorporates the fundamental durability and neighborhood structure aspects of housing, and explicitly allows for the interactions of housing submarkets in response to supply-demand imbalances for dwellings providing different quantities of services or imbalances for dwellings with particular sets of neighborhood attributes, especially the racial and socioeconomic characteristics of others living in the neighborhood. The behavior of households as consumers of housing services and landlords as suppliers of services in the model is based upon extensive empirical evidence.

SIMULATING VARIOUS SUBSIDY APPROACHES

The model has been used to simulate a number of possible Federal interventions in four prototypical market situations, each in turn having a variation allowing for different degrees of elasticity in the supply of housing from the existing stock. The relevant simulations have involved housing allowances; new construction subsidies for all private residential building; and a mix of allowances with new construction/major rehabilitation. The latter case is described in report No. 221-09 while the others are described in No. 12700, chapter 6.

Report No. 12700 describes simulations made using the Institute's market model for various possible subsidies in differing market situations. Not only are policies contrasted, but the various types of situations are classified in terms of whether the market areas are high- or low-growth and whether housing supply from the existing stock is elastic or inelastic. The changes described are for a 10-year span.

By and large, the results of the various simulations emphasize the diversity of market conditions. Six different program policies are simulated: a continuation of the policies that characterized the 1960's, with major reliance upon supplying new units of housing via various interest rate or direct construction subsidies; a comprehensive housing allowance; a smaller allowance program; an income maintenance strategy; a long-term (two decade) allowance; and removal of all minimum standards for new construction.

The results of these various simulations vary widely, not only among themselves but each in terms of its impact upon divergent market conditions. In qualitative terms, the principal results were:

A full-scale allowance program (22 percent of all households eligible) would, in many locations, significantly increase housing prices paid by participants;

Income redistribution without any earmarking for housing would also drive up housing prices, but by less than an allowance;

The inflationary danger of a housing allowance varies widely with background circumstances. It is most severe where prices per unit of housing service initially are especially low relative to new construction costs—where low-quality housing, in other words, is relatively cheap;

Most of the upward price movement due to a housing allowance affects participants directly. Households above eligibility levels suffer only minor price increases;

The price effects of housing allowances are much greater over a 10-year span than over a 20-year span;

An across-the-board new construction subsidy (i.e., a filtering strategy) lowers housing prices of both new and existing housing at all quality levels;

Eliminating minimum standards for new construction causes small decreases in housing prices at the low end of the quality range, especially in areas where these prices initially are high compared to the price of new construction.

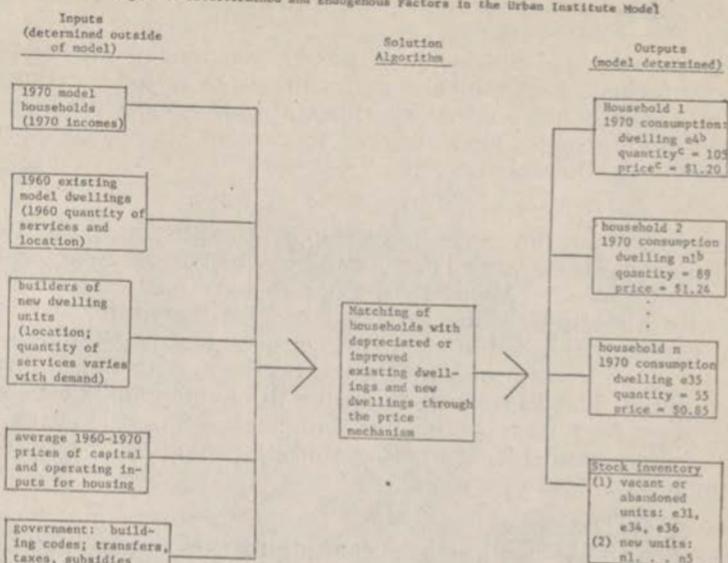
ALLOWANCES COMBINED WITH NEW CONSTRUCTION/MAJOR
REHABILITATION

Special attention has been paid to combining subsidies, particularly allowances with new construction or major rehabilitation. In this work, total program costs were assumed to be the same as the work cited above, wherein 22 percent of all households were eligible for allowances. This provides comparability across the various approaches. In report No. 221-09, a smaller allowance was also combined with two different supply-side subsidies, one lowering the price of new construction and the other lowering the cost of rehabilitation. In these cases, the total cost of the allowance program was lowered commensurately, by reducing the proportion of households eligible to participate.

The main objective of combining housing allowances with supply-side subsidies is to reduce the potential price increases associated with the allowances. Price increases are undesirable not only because they tend to redistribute the subsidy benefits away from participants to property owners, but also because ineligible households may have to pay higher housing prices as well. In a situation characterized by a relatively high proportion of minority families plus slow growth of lower income households, a combination of an allowance with new construction or major rehabilitation subsidy could be sufficient to control potential price increases, although only the rehabilitation subsidy is able to match the larger allowance program's increase in housing consumption among lowest income households. Conceivably a new construction subsidy which focused its subsidies more intensively upon the very lowest quality permissible for new construction could achieve some of the increased consumption of the rehabilitation subsidy. The control on prices exercised by both supply-side subsidies is sufficient to stop the redistribution of allowance program benefits from low-income recipients to high-income landlords.

In the example of a high-growth and high-minority city, the allowance program causes no major price increases to allowance participants, and there would be little need for a companion supply-side subsidy if minimum-sized units are built by private builders to satisfy the demand for this type of housing from families whose incomes are too high for assistance, but too low for higher priced new housing. This is a critical "if," however, for if builders are not motivated to fill this demand, in a critical range of housing need, public intervention to stimulate such new construction would be warranted.

Figure 1. Predetermined and Endogenous Factors in the Urban Institute Model



^a location characterized by employment access (travel time) and racial-economic status of households at that location

^b e4 refers to the fourth existing dwelling; n1 refers to the first new dwelling

^c price is the price per unit of housing services; quantity is the quantity of services per month

TABLE 2.—CHARACTERISTICS OF 4 PROTOTYPICAL METROPOLITAN AREAS

	City			
	Cloth: High minority; rapid growth	Steel: High minority; slow growth	Far West: Low minority; rapid growth	Grain: Low minority; slow growth
Minority households as a percent of total, 1970.....	20	21	5	6
1960-70 growth of low-to-moderate income households..	+12	-3	-22	-3
1960-70 growth of all households.....	+25	+7	+39	+13
Number of model households:				
1960.....	31	31	31	31
1970.....	40	33	43	35
Percentage of all SMSA's represented by city.....	30	38	21	10
Percentage of total SMSA population represented by city.	20	26	25	28

III. THE EXPERIMENTAL HOUSING ALLOWANCE PROGRAM

PROGRAM DESCRIPTION

The experimental housing allowance program (EHAP) was authorized by the Congress under sections 501 and 504 of the Housing Act of 1970. Housing allowances provide direct cash assistance to lower income families to enable them to obtain adequate housing at reasonable cost. Participants select their own units, which must meet some quality requirements, and allowances are paid directly to the household, rather than directed to a specific unit, as is the case in many other programs.

After extensive design work, the EHAP was initiated in 1973 at 12 sites throughout the Nation. These sites represent broad geographic, economic, and demographic diversity. They range from a large metropolitan area with a population of more than 1.6 million to a program

site that includes four rural counties with a total population of about 100,000.

A major aspect of the design of EHAP was an explicit decision to obtain information on the basic policy questions raised by allowances in three separate but related experimental elements, linked by a common program design. Each element focuses on a key issue involved in the housing allowance concept:

1. The demand experiment

Designed to test how households respond to allowances, the demand experiment has been carried out in two large metropolitan areas, Pittsburgh and Phoenix. About 1,250 families have participated in each site, with allowances being provided in 17 different forms. Control groups were established at each site, consisting of households not receiving allowances, to compare their experiences with families receiving subsidies. The demand experiment will be completed by February 1977, except for final reporting and data analysis; participating families will have been shifted to other subsidy programs, if eligible and willing to participate.

2. Supply experiment

Designed to test how the local housing market responds to the impact of an allowance program, this aspect of EHAP is being carried out in two small SMSA's, Green Bay, Wis., and South Bend, Ind. In these two sites the enrollment is open, unlike the situation in either the demand or administrative agency experiments, and any renter or owner household meeting income and housing quality standards is eligible. This is the only aspect of EHAP in which homeowners can be participants. The supply experiment may continue to enroll households until 1984.

The supply experiment addresses four primary research areas: (1) supply responsiveness, including price changes and housing improvements; (2) the behavior of market intermediaries and indirect suppliers; (3) changes in residential mobility and neighborhood patterns; and (4) the effects on nonparticipants, particularly with respect to changes in housing prices for those within or just above the range of eligibility.

3. The administrative agency experiment (AAE)

The AAE is designed to provide insights into various methods of administering an allowance program under different circumstances and through different local agencies. Eight public agencies are involved—two local housing authorities, two metropolitan area county government agencies, two State community development agencies, and two welfare agencies.¹ Each was given broad latitude to design and implement methods of managing an allowance program. The AAE has now been closed out, and final analysis of its progress is underway. Participating families have been shifted to other subsidy programs.

The Urban Institute's role in this overall effort is to provide a fourth research component:

¹ The AAE sites are: Bismarck, N. Dak.; Durham, N.C.; Jacksonville, Fla.; Peoria, Ill.; Salem, Oreg.; San Bernardino, Calif.; Springfield, Mass.; and Tulsa, Okla.

4. *The integrated analysis*

To draw upon all sources of experimental data and analysis, link them appropriately to nonexperimental data, and provide an important information source in determining how the housing allowance concept ties into the development of a national housing policy.

The integrated analysis, designed for comprehensive use of the total EHAP experience, serves a number of purposes. First, it analyzes comparable data drawn from the experiments, contributing selective analysis necessary to complete the answers to research and policy questions in important areas of EHAP research. It does not involve duplication of analysis carried out in the individual experiments. Second, it generalizes EHAP findings, so that the results observed at the relatively small number of EHAP sites and in the different experimental contexts can be interpreted in general terms appropriate to the development of national housing policy. Finally, the integrated analysis synthesizes and appraises all EHAP results, making them understandable to a wider community as well as more useful in the process of policy development.

EHAP: WHAT HAS BEEN LEARNED TO DATE

1. *Household participation*

There have been more than 51,000 applicants for allowances in all three experiments, and less than half of these (24,675) were enrolled into the program. However, due to terminations for a variety of reasons, only 18,683 households have received payments through November 1976 (table 3).

A breakdown of the population groups through various stages of enrollment process is shown on table 4. Some groups (for example, the elderly, the working poor) were more difficult to reach and to enroll in the program than others (for example, welfare households). (See Report 216-24, pp. 11-20.)

Average adjusted incomes of participating households have ranged from \$2,000 to \$4,700 annually (see tables 5, 6, and 7). Average monthly payments ranged from \$72 to \$89 at the various sites in the administrative agency experiment, from \$53 to \$73 in the two demand experiment sites, and from \$60 to \$87 in the supply experiment sites (for renters).

2. *Program administration*

As indicated, a variety of agencies administered the program but all had to manage the same basic approach of matching up households with qualified housing and allowance payments. Households had to be contacted, make application, prove that they met income and housing quality standards (either by living in a standard unit or by moving to one), and then begin receiving allowance payments.

Not only were the outreach and income certification functions managed in a variety of ways, particularly in the AAE, but a number of different forms and intensities of counseling and other services were provided (see 216-24, pp. 20-32). In some instances, these services appeared to be instrumental in helping households meet housing quality standards, but almost always at some additional cost in pro-

gram administration. The relationship between these factors is still undergoing analysis. In the Demand and Supply experiments, sub-contractors to HUD have set up their own field offices, and the range and mix of services has been somewhat different from those provided in the AAE.

Most families in the EHAP had to be living in units that met certain housing standards before they could receive payments. The various experiments used different sets of standards. It was found that differences in standards, rather than differences in the housing itself, caused a higher failure rate in the Demand experiment, where, on a comparable basis, 75 percent of the units failed to meet first inspection standards compared to 60 percent in the two Supply sites. (For full discussion of standards utilized, see 216-30, September 1976.)

Analysis of administrative functions has been a prominent part of the EHAP research to date, as indicated above. Paper 216-31 not only summarizes this work (see table 8), but also discusses intergovernmental relations in the EHAP and work that has been done in integrating the allowance program requirements with those of other programs, such as welfare and public housing.

3. Program costs

The largest part of program costs are accounted for by allowance payments to families, the remainder for administrative expenses. Tables 5, 6, and 7 show average monthly payments to allowance recipients for each of the three experiments. In the AAE administrative costs totalled about 20 percent of all costs.

Administrative costs have varied throughout the experiment, due to local conditions and differences in management methods of each administering agency. Although much of the work in this area remains to be completed or is in draft form, 216-31 contains a summary section on costs (pp. 68-77). Costs have been broken down a number of ways, but one analysis separates out "intake" costs (the cost of enrolling a family and bringing it into the program) and maintenance costs (the cost of continuing to provide allowance payments and services). In the AAE, keeping in mind wide variations across the eight agencies, the median intake cost per household was \$225. In the Supply Experiment, the latest comparable figures are \$218 in Green Bay and \$250 in South Bend.

Maintenance costs appear to be \$204 per household annually in the AAE, and similar costs in the Supply Experiment are about \$143 per year in Green Bay and \$84 in South Bend. Analysis is still underway to insure a more accurate degree of comparability in these cost figures than is now available.

Within the AAE itself, administrative costs varied widely. Total costs for getting a household into the program and maintaining it for 5 years were \$204 per year per household in Tulsa, and \$429 in Jacksonville.

A significant portion of administrative costs was accounted for by families that were contacted and even enrolled but never became allowance recipients. In the AAE, an estimated 36 percent of total intake costs are attributable to this circumstance. In the Supply Experiment, it is estimated that enrollment costs per new recipient could be reduced by 39 percent if all enrollees could be converted to recipients.

There are many important caveats inherent in attempting to compare costs in an effort as far ranging and complex as EHAP and these are emphasized on pages 74-77 of the Administrative Research report. See also table 8 for a summary comparison of various administrative approaches.

4. *How were allowance recipients affected?*

Recipients of allowances were affected in a variety of ways. In every case, their circumstances were improved, either through giving them the means to move to a better unit in a better neighborhood, or the means to reduce the percentage of their income they had to pay for housing. Special difficulties were faced by minority participants particularly in Jacksonville as part of the AAE.

(a) *Changes in percentage of income paid for housing.*—Allowances have markedly reduced the rent burden for participating families. Experience in the Supply Experiment to date indicates that this is the predominant effect upon participating families in Green Bay and South Bend. In the Demand Experiment, the percentage of income spent on housing in Pittsburgh dropped from 41 percent to 24 percent, and in Phoenix from 42 percent to 23 percent (216-24).

In EHAP, unlike section 8, recipients are not limited by a fair market rent ceiling, but can pay as much of their incomes for housing as they desire, understanding that any amounts paid beyond the EHAP cost limit must be paid with their own incomes (240-01). Another contrast is that income limits are higher in section 8 than in EHAP. In the two Demand Experiment cities 43 percent (in Pittsburgh) and 52 percent (in Phoenix) of recipients that met housing requirements at enrollment were spending more than the estimated cost of adequate housing. This would imply that if a section 8 type limit were imposed, roughly half the families in those cities would be excluded unless they moved to cheaper units, and the other side of the coin is that removal of the rent ceiling would greatly increase participation in section 8.

(b) *Changes in housing quality.*—Housing quality standards have already been mentioned—in the AAE about 43 percent of recipient households met housing requirements at enrollment, and about half of those in the Supply Experiment met requirements without either moving or upgrading their units.

Moving to a better unit—often in a better neighborhood—was one of the three ways a household had of becoming eligible for payments. In Phoenix, most enrollees met housing requirements by moving. And in the AAE 45 percent of all recipients moved in order to receive payments.

There was not a significant amount of improvement undertaken to bring currently occupied units up to standard in any of the EHAP sites. In the AAE sites from 2 to 21 percent of tenants upgraded the quality of their units, rather than move (see table 9). In the supply experiment there is a comparability problem because housing conditions are so different in the two sites. But amounts spent for repairs to bring units to standard have generally averaged under \$50.

One important lesson from the Demand Experiment is that moving in itself does not guarantee attainment of housing that meets standards—only half of the movers in the Demand sites met requirements

after their moves. Although moving does improve the chances of a household receiving an allowance, there is no evidence that the allowance program markedly influences the propensity of households to move. Surveys indicate that many of these families would probably have moved anyway.

The tightness of the local housing market also appears to influence whether or not enrollees who move eventually become allowance recipients. For instance, in the AAE approximately 60 percent of enrollees in tight markets (4-6 percent vacancy rates) became recipients, contrasted to 85 percent of enrollees in looser markets (8-13 percent vacancies). Further work on this important area is being done, and no final conclusions are yet possible.

(c) *Changes in neighborhood quality.*—About half of the households that moved in the AAE sites upgraded the quality of their neighborhoods via the move (based upon an index taking into account income, education, and white collar employment of census tract residents). But another 29 percent of the movers were in lower quality neighborhoods, according to the index. Black households that moved outside their original census tracts improved their level of neighborhood quality more than white households, but the average quality of neighborhoods in which minorities lived was substantially below those of whites both before and after moving (216-24, pp. 42-44).

(d) *The minority experience.*—Participation of minority families in EHAP has varied widely. In Green Bay, with a very small minority population, only 2 percent of EHAP enrollees were minorities (and three times more Mexican-American than black families); while in South Bend, 31 percent of enrolled households were minority. The range in the AAE varied from 2 percent in Bismark to 66 percent in Jacksonville. The San Bernardino minority population is $\frac{2}{3}$ Spanish-American. In Pittsburgh minority enrollees constituted 26 percent of the total, and in Phoenix, where the dominant minority is Mexican-American, the percentage was 39.

In both the AAE and Demand experiments, minority families were less likely to become recipients of allowances than nonminority households. Only 57 percent of minority households enrolled (i.e., eligible for payments in terms of income, though not necessarily in terms of housing standards) actually received them in the AAE, compared to 76 percent of white households. In the Demand Experiment, only 43 percent of minority households became recipients compared to 52 percent of nonminority households (216-24).

One site offered particular difficulty for black households—Jacksonville, Fla. Only 21 percent of black enrollees during the first enrollment period became allowance recipients there, compared to 54 percent of nonminority households enrolled. There were at least two reasons for this: Housing quality of black households at time of enrollment was significantly lower than that of nonminorities, so a greater proportion of blacks would have to move to meet program requirements. But the Jacksonville market is severely segregated, and black households appeared unwilling to challenge existing patterns of segregation in their housing search (216-24).

Spanish-American households generally had less trouble in securing housing that met program requirements, particularly in the two sites with significant numbers of Spanish-American households (Phoenix

and San Bernardino—see 216-25). In general, few households moved outside their neighborhoods and there is no evidence that minority families found eligible units in locations (e.g., suburbia) far removed from their original inner-city neighborhoods (249-01). This further underscores early findings in Wilmington, Delaware, and Kansas City (210-6).

Research is still continuing on the issues involved in the experience of minorities in the EHAP, especially regarding mobility and locational choice in various of the sites.

5. Price changes in varying market situations

One of the principal issues involved in a housing allowance approach is the effect it will have upon the price of housing throughout the markets involved. This question is the focus of one aspect of the EHAP, the Supply Experiment. Although market conditions are quite different in the two sites (Green Bay and South Bend), in neither site has there been any evidence of price inflation in either rentals or home prices that can be ascribed to the allowance program. Nor has there been any evidence of neighborhood turnover.

In Green Bay, where 6 percent of all households are allowance recipients, gross rents rose at about a 6 percent annual rate, but nearly all of this increase was due to higher costs for fuels and electricity. In fact, rents for program participants have risen by less than the market average.

In an effort to explore further this vital issue, the Urban Institute has employed its market model to measure price inflation in the two supply experiment sites, presuming an allowance program had been in effect during the 1960's. If that had been the case, and positing a 10-percent household participation rate in Green Bay, housing price inflation would have been negligible. In South Bend, although the prices of housing would have risen substantially during the same period, the higher costs would still be less than the cost of new housing for allowance recipients. (Fourth Annual Report, Integrated Analysis and 216-26 and 216-27)

6. Program acceptance

Evidence to date indicate that a housing allowance program is capable of attracting many applicants within a relatively short time, although some groups (e.g., elderly) are particularly difficult to get into the program. The type and intensity of outreach programs can be influential in affecting overall participation rates (216-24).

Housing allowances have been well received in the 10 communities where there is significant awareness of the program. Local acceptance appears to be related to the conditions of the local housing market, local economic conditions, and the general attitude of the community toward Federal assistance programs (216-24). During the past year there has been a higher level of community acceptance in South Bend.

7. Housing allowances in low-income rural areas

While EHAP has been carried out predominantly in urban and exurban areas, a special study was undertaken to determine what effect an allowance program might have in rural areas (216-1). There are an estimated 4.2 million to 4.5 million rural households which might be eligible for an allowance program, and about 45 percent of them live in substandard dwellings. The study concludes that while

an allowance program would be feasible in most rural areas, there are probably some situations where direct cash assistance should be supplemented with other programs such as: (1) where there is a high proportion of substandard units; (2) where there has been a decade of declining population and per capita income is low; and (3) where there are groups requiring special assistance such as Alaskan natives, migrants, or no-cash renters now living in substandard units.

Rural housing markets are short on credit and the usual factors of production (labor, materials, etc.) and allowances would have to be carefully fitted to given areas in such a way that severe dislocations do not result. It is also important to recognize differences in county market situations—most substandard rural housing is in counties that are not, on the whole, declining but the situation is different in the South where most substandard housing is in declining counties. These areas would probably require some type of long-term supplementary supply-side program in order to meet the urgent need for standard units.

8. Housing allowances and the welfare system

A national housing allowance program could constitute an important part of the present welfare system, but that system is currently undergoing another broad-gauge review, with an eye to major overhaul. The Institute has explored the dominant issues of how a direct cash transfer program for housing might fit into the existing welfare system, or with a negative income tax. (216-4). The study also contrasts these two possible alternatives with a straight negative income tax having no earmarking for housing, in terms of costs and benefits to participants.

The work indicates that a national housing allowance program would provide an important source of supplemental income to lower income families which need more aid than can be provided through other "welfare" payments such as Food Stamps. The Food Stamp program is particularly analogous to a direct cash assistance program for housing, in terms of eligibility of families, payment levels, and administrative forms, and the two programs would dovetail effectively together. However, housing allowances would perhaps be inefficient and duplicative for families eligible for ADFC or SSI, and could have a significant adverse effect on the work effort of ADFC eligible households, particularly in States with high benefit levels. However, limitations could be placed upon the combinations of programs that eligible families could take advantage of, and thereby make housing allowances more effective. This program-linking strategy is being explored further in continuing work at the Institute.

TABLE 3.—EXPERIMENTAL HOUSING ALLOWANCE PROGRAM: NUMBERS OF HOUSEHOLDS PARTICIPATING AT VARIOUS STAGES¹

Program	Applicants	Enrollees	Recipients
Supply Experiment.....	26,526	12,764	9,766
Demand Experiment.....	5,488	2,523	2,523
Administrative Agency Experiment.....	19,678	9,388	6,394
Totals.....	51,692	24,675	18,683

¹ Numbers approximate peak levels for each experiment.

TABLE 4.—POPULATION PROFILES: ADMINISTRATIVE AGENCY AND DEMAND EXPERIMENTS

[In percent of population]

Households characteristics	Administrative agency experiment				Demand experiment			
	Eligible ¹	Applicant	Enrolled	Recipient	Eligible ¹	Applicant	Enrolled	Recipient
Population groups: ²								
Elderly.....	27	12	16	17	31	23	23	16
Welfare.....	15	55	53	52	31	40	41	42
Working poor.....	58	33	32	31	38	38	36	42
Sex of head:								
Male.....	43	33	35	35	49	47	45	45
Female.....	57	67	65	65	52	53	55	55
Race/ethnicity:								
Nonminority.....	76	62	68	74	70	68	68	72
Minority.....	24	38	32	26	31	32	33	28

¹ Census data are used to estimate the eligible population in the Administrative Agency Experiment; and EHP survey of the population at the experiment sites is used to estimate the eligible population in the demand experiment. Use of census data for the AAE makes comparisons of the eligible population across experiments difficult since different time periods were used, household characteristics are defined differently, and the method of data collection differs. In particular, the welfare population as a percentage of the total eligible population in the Administrative Agency Experiment is probably underestimated and the percentage working poor overestimated due to these factors.

² Households are characterized as elderly if the head is 65 yr of age or more; welfare if they receive any income from welfare and are nonelderly; working poor if they are neither elderly nor welfare households.

Note: Totals do not always add up to 100 percent due to rounding.

TABLE 5.—STATUS OF OPERATIONS OF THE ADMINISTRATIVE AGENCY EXPERIMENT THROUGH JANUARY 1976

Site and operating time period	Recipient households			
	After 1st year of operation ¹			
	January 1976 number	Number	Average adjusted income ²	Average monthly payment
Salem, Oreg.: March 1973 to January 1976.....	0	870	\$2,800	\$84
Springfield, Mass.: April 1973 to February 1976.....	19	861	3,000	89
Peoria, Ill.: April 1973 to February 1976.....	0	835	3,700	85
San Bernardino, Calif.: March 1973 to March 1976.....	24	776	2,900	84
Bismarck, N. Dak.: July 1973 to April 1976.....	26	367	3,000	72
Jacksonville Fla.: April 1973 to July 1977: ³				
1st enrollment.....	10	300	2,000	86
2d enrollment.....	435	541	3,200	74
Durham, N. C.: July 1973 to April 1976.....	136	483	2,400	74
Tulsa, Okla.: August 1973 to May 1976.....	273	825	2,700	72

¹ This represents steady-state operations for the experiment.

² Gross annual income minus deductions for dependents, medical expenses, etc.

³ The operating period in Jacksonville is longer than at other locations because enrollment was reopened.

TABLE 6.—STATUS OF OPERATIONS OF THE DEMAND EXPERIMENT THROUGH JANUARY 1976

Site and operating time period	Recipient households		
	Number ¹	Average adjusted income ²	Average monthly payment
Pittsburgh, Pa.: April 1973 to February 1977.....	667	\$4,600	\$53
Phoenix, Ariz.: May 1973 to February 1977.....	546	4,700	73

¹ In addition, there were 119 households in Pittsburgh and 116 households in Phoenix who were in a temporary inactive status as of January 1976. There were also 279 enrolled households in Pittsburgh and 276 households in Phoenix who were not meeting requirements which would enable them to receive payments.

² Gross annual income minus Federal and State income taxes, social security taxes, an allowance for work-related expenses, medical expenses, etc.

TABLE 7.—STATUS OF OPERATIONS OF THE SUPPLY EXPERIMENT THROUGH JANUARY 1976

Housing tenure by site and operating time period	Recipient households		
	Number	Average adjusted income ¹	Average monthly payment
Green Bay, Wis.: June 1974 to June 1984:			
Renters.....	1,377	\$3,400	\$60
Homeowners.....	1,030	3,600	53
Total.....	2,407	3,500	57
South Bend, Ind.: December 1974 to December 1984:			
Renters.....	978	2,100	87
Homeowners.....	1,330	3,200	58
Total.....	2,308	2,800	70

¹ Gross annual income minus deductions for dependents, medical expenses, etc.

TABLE 8.—COMPARATIVE ADVANTAGES AND WEAKNESSES OF THE 3 EHAP EXPERIMENTS FOR ADDRESSING ADMINISTRATIVE ISSUES

	Advantages	Weaknesses
Administrative Agency Experiment.....	1. Administered by existing agencies. 2. Cross-site variation in choice of administrative procedures.	1. Difficulty in attributing outcomes to administrative variations.
Demand Experiment.....	1. Monthly income accounting system. 2. Housing Information sessions (Control group analysis).	1. Maintaining treatment integrity given priority over administrative efficiency.
Supply Experiment.....	1. Homeowners eligible. 2. Open enrollment; "steady-state" approximation. 3. Within-site, overtime variations in choice of some procedures (e.g., certification).	1. Limitations on variations in basic program design. 2. Difficulty in separating true administrative costs from experimental costs.

TABLE 9.—METHODS OF ATTAINING RECIPIENT STATUS: ADMINISTRATIVE AGENCY EXPERIMENT

Site	Percent of recipients			Number
	Staying with rehabilitation (percent)	Staying without rehabilitation (percent)	Moving (percent)	
Total.....	12	43	45	5,756
Salem.....	2	46	53	948
Springfield.....	17	38	45	851
Peoria.....	4	56	40	935
San Bernardino.....	19	35	46	822
Bismarck.....	6	70	24	430
Jacksonville.....	21	19	61	339
Durham.....	9	45	47	516
Tulsa.....	21	35	44	915

Note: Categories denote household behavior between enrollment in program and receipt of 1st allowance payment, a maximum period of 3 months. "Staying without rehabilitation" is equivalent to "met earmarking at enrollment" in table 1.

Source: "Third Annual Report of the Administrative Agency Experiment Evaluation" (Draft) (Cambridge, Mass.: Abt Associates, Inc., August 1976), table B-3.

IV. CONVENTIONAL PUBLIC HOUSING

This is the largest Federal program serving low-income households. There are now over 1.1 million occupied units throughout the Nation, most of them located in central cities. Approximately 51 percent of all tenant households are receiving welfare assistance, and about 45 percent are elderly, about 43 percent of whom are on welfare. Only

about 23 percent of public housing tenant households are nonelderly, nonwelfare households.

While new construction of public housing has lagged in recent years for a variety of reasons, including local opposition, there has been a growing interest in the problems of managing this substantial stock of housing. A principal reason for this interest is the continuing increase in the need for Federal subsidies to cover the shortfall between rent revenues and operating costs—subsidy costs in fiscal year 1977 amounted to almost \$600 million. Under various congressional mandates, families in public housing can pay no more than 25 percent of their incomes for rent, while at the same time operating costs have escalated sharply, resulting in the need for Federal operating subsidies.

The steep rise in operating costs prompted HUD's interest in management, and particularly in the development of measures of management performance. HUD and the Congress share a concern that operating subsidies *not* be used to continue wasteful and inefficient management practices. HUD asked the Urban Institute to undertake the definition and measurement of performance, with an eye to establishing the relationships between management practice and expense levels of local public housing agencies (PHA's).

In the course of developing measures of management performance and practice as well as measures of PHA operating conditions, for example, neighborhood services, the Institute carried out over 30,000 interviews with tenants, managers, PHA executives, and others and has amassed the largest body of data ever assembled regarding housing management. Much of this data is still being analyzed, but the Institute has arrived at some conclusions regarding what constitutes sound management, and has provided the Department with a prototype equation that forms a major element in the performance funding system, now being used as the principal tool for determining the levels of operating subsidies.

The data was analyzed with the objective of understanding the dynamics of the management process, and particularly of delineating the key factors in the improvement of housing management performance. The measures that were derived reflect the feeling that human attitudes and perceptions are as valuable in establishing performance measures as are enumerations of some fairly objectively quantified measures of the management process—for example, vacancy rates and rent collection losses. Thus many of the key variables used to measure performance involve the perceptions of public housing tenants—the consumers of the housing services provided by PHA's. Other measures comprise the perceptions of project staff, central office staff, or HUD area office personnel.

The Institute developed four basic sets of variables: (1) management variables describing agency organization, policies, and practices; (2) control variables measuring environmental factors and agency characteristics over which the PHA has little or no control, such as neighborhood conditions and the age of project buildings; (3) income and expense measures based upon actual experience; and (4) criterion variables which measure the overall performance of the agency. These are described fully in 209-5-2.

Analyses of the interrelationships among these variables pointed the way to a sounder understanding of the dynamics of change in management operations. At this time, HUD had undertaken the Housing Management Improvement Program (HMIP) and was particularly interested in steps that might be taken to upgrade performance in larger PHA's. Under this effort, 13 PHA's—later reduced to 11—took various specific steps to upgrade their management, and the Institute has provided continuing oversight of the program.

The Institute's work has shown definitively that sound management performance rests squarely upon five basic precepts:

Strictness in enforcing rules—for example rent collection, rules for tenant behavior;

Management's responsiveness to tenant needs—for example, the time it takes to respond to requests for maintenance;

Tenants' concern for the project and their positive involvement in management operations;

Good coordination between central office and project staffs;

Decentralization of decisionmaking authority to the project level.

These precepts not only are the governing agents in management performance in public housing but also in privately owned and managed housing for low- and moderate-income families. The institute has also studied management experience at 60 FHA-insured projects and found that these same principles are vitally important in performance (209-6-2).

The Institute has discovered that this set of principles is strongly related to two other key factors in management: operating costs and neighborhood conditions. Operating costs are lower when these qualities are present, and the differences in costs are significant—for example, in larger PHA's where strictness in rule enforcement was in strong evidence, per unit costs were \$21 per month lower than in large PHA's which had lower strictness scores.

Another important finding relates management principles to neighborhood conditions. The Institute's analysis indicates that perceptions of neighborhood conditions are closely related to management performance and practice. Where it was perceived that neighborhood conditions have deteriorated, it is likely to be the case that management performance has declined and that management is using less effective techniques as well. Recent Institute work has again underscored this vital correlation between measures of management strictness, responsiveness, tenant concern, etc. with perceptions of neighborhood conditions.

The close correlation of neighborhood conditions with housing management performance emphasizes again the vital importance of the management of not only the housing stock but the whole community. For example, the presence of litter and abandoned cars in the neighborhood surrounding a public housing project is associated with poorer management performance at the project. In this regard, the Institute's work in the area of housing management blends with its other concerns with housing markets, the administration of local programs, and the need to understand that public interventions should be fitted to meet often widely divergent local needs.

The major body of the Institute's work in housing management deals with measuring and improving management performance. This work is linked directly to the related studies of establishing and administering Federal subsidies to local public housing authorities, and specifically with the continuing development of the performance funding system. Finally, the other key aspect of the Institute's work in management has involved the measurement of costs, and the relative importance of various facets of costs (e.g., utilities) in the operations of the PHA's. The work has involved not only sophisticated simulations of several important elements of management operations, but also less formally structured explorations of the intricate web of decisions and administrative actions that form housing management.

1. Measuring and improving management performance

Initially designed to provide a data base for measuring progress of the housing management improvement program at 12 PHA's, the Institute's work in developing measures of performance has taken on greater importance in the past several years. As already indicated, one of the key findings was that several characteristics of good management performance (e.g., strictness in making and enforcing rules, responsiveness to tenant needs, tenant concern for the project and its environment) are directly related to actual operating costs per unit month (209-5-2).

Continuing oversight of the HMIP underscored the institute's earlier findings, and also found that a number of projects that did not receive HMIP funds but were used as control group projects during the demonstration, performed as well or better than did the HMIP recipients (222-52-2).

The HMIP provided an impetus to concentrate upon measures that lead to significant improvements in management performance. But an effort was made to broaden the scope of the inquiry to include projects not involved with HMIP in studying what specific steps PHA's had taken to improve performance. Change scores (scores obtained in 1976 minus comparable scores obtained earlier) were analyzed and 25 projects selected, most of which had significantly improved their performance scores since 1973, and a few of which showed dramatic downturns. In every case, the object was to discover what specific actions management had taken—or not taken—that would have affected the scores (239-00).

Project visits clearly emphasized the importance of earlier findings regarding the application of basic management principles. But they also showed that money alone is not sufficient to turn management performance around (some projects with substantial modernization funds still did not show higher performance scores) and significant gains depend upon major institutional change at all levels of the PHA. Where this has been happening, project scores are rising for most of the agencies' developments.

2. Administering operating subsidies

The improvement of management performance is closely linked to per unit subsidy levels (higher scoring projects generally operate at lower monthly costs than low-scoring projects). The Institute has played a vital and continuing role in the development and refinement

of HUD's Performance Funding System (PFS), particularly in the development of the prototype equation that uses actual operating expenses (excluding utilities) of high-performance PHA's as a yardstick against which to measure expense levels of all PHA's operating under the same conditions (209-43-1). The equation permits differences in operating conditions over which the PHA's have little or no control (e.g., regional variations in cost) to be taken into consideration in determining whether PHA operating costs are within normal limits. The Institute found that there are wide variations in operating costs for PHA's in different sections of the Nation, as well as within or outside the same metropolitan area (223-2). The prototype equation along with the rules and regulations which govern how the equation is used and how utility costs, rental income, and other budget items are determined form the whole FPS.

The Institute has recently completed an analysis of the first year of experience under the PFS. Some of the key findings are:

Total operating expenses for all size PHA's have risen more than 40 percent since 1973:

Utility costs have risen over 60 percent for large and medium-sized PHA's, and nearly 50 percent for small PHA's;

There is some evidence that the PFS is constraining nonutility expense levels;

In the 3-year period, there is some evidence of decline in the management performance of PHA's of all sizes;

Directors of large PHA's have more negative feelings about the PFS than do directors of smaller sized PHA's;

There is no evidence that the PFS had resulted in lower levels of services.

3. Analyzing operating costs

Much of the Institute's early work in public housing management involved analyzing operating costs, which had, in the late 1960's, begun to rise alarmingly. Part of this analysis pointed clearly to the need for operating subsidies for PHA's, as a more palatable alternative to raising tenant rents, which would have had to be increased by more than 8 percent each year just to stay even with costs—and that was before the soaring cost of utilities threw all predictions out of kilter (30001). At the time, family incomes were rising at a 3-percent annual rate, not nearly sufficient to cover cost increases even if Congress had not constrained rents to no more than 25 percent of family income.

Further studies indicated not only that operating costs were accelerating, but that there were significant differences in cost levels for PHA's in different parts of the Nation and between large and small PHA's as well as those in central city versus noncentral city locations (57000 and see table 10). Large PHA's in central cities located in the Northeast or California generally showed higher costs, and steeper rates of increase than those in the Southeast or Southwest.

These differences are not as significant in FHA-insured subsidized projects for low- and moderate-income families (209-1). Analysis of data from 65 projects for the 1965-70 period showed that while there were significant regional differences in costs, just as there are in public housing, differences were much less significant between city, suburban, or nonmetropolitan locations.

Other comparisons of public housing costs with those of FHA-subsidized projects indicate that the same relationships between performance and operating costs show up for those projects as well as for public housing. The studies (112-27 and 209-1) indicate also that there is no single "correct" management approach that will work in every situation, but that different styles must be found that both fit local variations and embrace the basic precepts of high management performance.

In the development of the PFS, HUD had to take account of the most volatile element in the cost picture for PHA's—utility costs. As part of the data collection leading to analysis of management performance, the Institute added questions regarding conservation measures and utility costs for 273 projects in 63 different PHA's. Ratings were used to gauge the relative effectiveness of various techniques that were used in an effort to cut back energy consumption. The paper recommends an incentive system for rewarding PHA's that effectively trim back consumption levels to replace the current system which offers little incentive to reduce energy consumption.

The steep rise in operating costs for public housing, and coincident need for substantial operating subsidies from the Federal Government, has prompted a number of studies of ways to reduce costs, increase productivity, or both. HUD initiated, early in 1976, a demonstration program involving performance incentives to PHA workers in eight authorities. The program is designed to test various incentive bonus systems, by way of learning the feasibility of such systems within the existing PHA system.

A special study of the British experience with work study programs involving building maintenance in public housing was carried out in 1974 by HUD and the Institute, and is reported in 222-51-1. Although the study cautions that the British experience is not directly transferable to the American scene because of unionization, wage levels, various sizes of housing authorities, and other reasons, the study nevertheless concludes that there appear to have been some savings as a result of the program, and that workers generally like those that have been instituted. Although many of the British studies are carelessly drawn, there is substantial evidence of higher productivity, significant reductions in per-unit maintenance costs, and shortened response times. A second report (209-1-4) by British housing expert, John Macey, also describes the British performance incentives system and makes specific recommendations for carrying out such programs in the United States.

TABLE 10.—MEAN RENTAL RECEIPTS AND OPERATING EXPENSES, 337 HOUSING AUTHORITIES, 1970

[Dollar amounts in per unit per month]

Region and central city location	Large LHA's (over 1,000 units)				Small LHA's (less than 1,000 units)			
	Number	Rental receipts	Operating expenses	Rent less expenses	Number	Rental receipts	Operating expenses	Rent less expenses
Northeast (HUD regions 1-3):								
Central city location.....	32	\$58.29	\$65.61	-\$7.32	7	\$54.00	\$55.99	-\$1.99
Noncentral city location..	12	58.83	60.52	-1.69	23	55.85	55.94	-.09
South (HUD regions 4, 6):								
Central city location.....	27	37.82	42.59	-4.77	6	34.86	36.89	-2.03
Noncentral city location..	12	36.88	41.88	-5.00	133	34.09	31.10	+2.99
Rest of United States (HUD regions 5, 7-10):								
Central city location.....	25	49.53	59.11	-9.58	5	48.26	46.93	+1.33
Noncentral city location..	8	49.88	56.44	-6.56	47	42.45	40.15	+2.30

Note: All large LHA's (subject to qualifications mentioned on pp. 2-3) are included in the sample, and hence there is no sampling error associated with their financial data. The small LHA's constitute a random sample of 15 percent of all eligible authorities. Sampling errors associated with operating expenses for small LHA's are approximately \$12.75 divided by the square root of the number of LHA's in each category. Thus, for small LHA's located in a central city in the South, where the sample size is 6, the sampling error for operating expenses is \$12.73 divided by 2.45 (the square root of 6), or \$5.20. For small LHA's located outside a central city in the South, where the sample size is 133, the sampling error for operating expenses is \$12.75 divided by 11.53, or \$1.10. Sampling errors for rental receipts are slightly smaller than for operating expenses, while sampling errors for rent-less-costs are only 10 or 20 percent of sampling errors for operating expenses.

V. OTHER PROGRAMS FOR HOUSING LOW-INCOME FAMILIES

SECTION 8 LEASED HOUSING PROGRAM

There are a number of similarities between the section 23 program and the more recently initiated section 8 program. Both have been subjects of some analysis by the Institute and a comprehensive monitoring of section 8 has just been started.

The section 8 existing housing program, like section 23, deals with the leasing of units for families with incomes low enough to make them eligible for the programs. The housing must meet certain physical standards.

In both programs there is a rent ceiling beyond which participating households may not pay. The rent ceiling in the two programs has been an object of study by the Institute. In order to understand how the ceiling affects participants and the market, the Institute analyzed evidence from the Experimental Housing Allowance Program (EHAP), where there is no rent ceiling throughout most of the experiment, and compared it to section 8 (240-01).

The rent ceiling in sections 8 and 23 insures that no participating household can spend more than 25 percent of its adjusted income for acceptable housing. It is designed also to prevent households from living in "luxury" units, and it limits the possibility that landlords will participate in price gouging. The ceiling also tends to target the subsidy upon those households that live in the worst housing, an effect that takes on added importance in a limited-entitlement program such as section 8.

The ceiling poses certain problems, however. The major one is that it narrows the range of housing choices available to low-income households. Examining evidence from EHAP, where there is no rent ceiling, the report concludes that removal of the rent ceiling would markedly raise potential participation in the section 8 existing hous-

ing program. And since participants who elected to rent units exceeding the rent ceiling would not have to be subsidized for the portion of their rent in excess of the ceiling (in EHAP, families paying more than a fair market rental must use their own resources), the additional cost of the program would be attributable to increased participation and not to a higher subsidy per participant.

Other work on the section 8 program has just gotten underway, and there are no working papers yet available. The work includes the following elements:

Development of survey instruments and selected samples to be used in three sectors of the Nation for collecting data on agencies participating in the section 8 existing housing program. Work will cover five topics: administrative fees and functions; recipient and landlord participation; fair market rents; housing quality standards; and project sponsor participation.

Analysis of EHAP for material that has relevance to section 8, especially in areas of fair market rents, various administrative approaches, and implications of homeowner participation.

Issues in program management will be analyzed, using data collected from 120 public housing authorities throughout the Nation.

The Institute's market model will be used to examine the consequences of using different mixes of section 8 (including new construction and major rehabilitation as well as existing housing) and other programs. Market effects of section 8 will also be an important part of this analysis.

SECTION 23 LEASED HOUSING PROGRAM

1. Leased housing program: A statistical review (112-30 3/71)

This report presents and analyzes data for all leased housing units in the program as of 1969. Data is organized in terms of: housing characteristics (pp. 4-12); occupant characteristics (pp. 16-21); program costs (pp. 22-31); and a special analysis of aggregated data for the 23 most populous cities with leasing programs. This report constitutes the statistical base for the Institute work described in 112-29.

2. The cost of leased housing (112-29 3/71)

Based upon the data collected for 112-30 described above, this study analyzes that data and concludes that while leasing costs are somewhat higher than the BLS "low-budget" cost of unassisted housing, they are a great deal lower than conventional or turnkey housing. Detailed discussion of cost relativities is organized in terms of: (1) actual costs at 61 leased housing authorities (pp. 5-18); (2) comparisons of leased housing costs with BLS "low-budget" unassisted housing (pp. 19-24); and (3) conventional and turnkey public housing (pp. 25-39). Implications of the analysis are examined (pp. 40-44).

3. Section 23 leasing program: Progress report (112-35 5/71)

Based upon interviews with staff members at 39 public housing authorities, this study focuses upon tenant selection and location of housing (pp. 4-6) and effects of the program upon tenants, the hous-

ing stock, and neighborhoods (pp. 7-10). The report concludes that leased housing has a higher degree of community acceptance, provides more units more quickly, and is less costly than conventional or turnkey public housing (pp. 11-13).

4. *Section 23 leased housing program (123-716-1 10/72)*

This brief report, based upon existing data and Institute interviews at 36 housing authorities, constitutes a summary of past Institute work (112-29, 112-30, and 112-35) and an update of some data. Costs are contrasted to those for conventional and turnkey public housing, and benefits are categorized in terms of tenants, housing stock, and neighborhoods. The report's findings support earlier Institute research: Section 23 provides benefits in terms of location in existing neighborhoods and tenant anonymity, as well as in lower costs, and the time it takes to bring units under management. Community acceptance is also higher for section 23 than for conventional public housing. However, because of the diversity of building types and scattered locations, section 23 housing presents some administrative problems for local housing authorities (pp. 652-653).

HOUSING THE ELDERLY

America's 13.3 million elderly households present a special challenge to housing policymakers. First, it is difficult for elderly households to make changes in their housing, particularly when they are homeowners (70 percent of elderly households own their homes, and many are debt free). They also frequently need special services which are often unavailable where they are currently living.

An Institute analysis of the 1973 annual housing survey makes three key points (0001-3):

Elderly live in more modest dwellings, as a rule, than the non-elderly. The homes of the elderly are usually smaller in size and lower in quality.

About 30 percent of all elderly households live in rural areas and their housing is substantially lower quality than their urban counterparts.

The urban elderly, while generally living in sound housing, often live in neighborhoods which they perceive to have serious problems.

Simply defining income is a special problem with the elderly, who receive many types of direct (for example, OASI and section 202 housing) and indirect benefits from all levels of government. The fact that the elderly are often homeowners or have other assets further complicates definitions of "wealth" (229-04).

The EHAP demonstrates some of the special difficulties involved in getting elderly households with low incomes to participate in an allowance program. Their participation rates were generally low. However, once elderly households were enrolled in the program they usually became recipients with less trouble than the nonelderly, because they lived in higher quality units in those particular areas (216-24).

The Institute has compiled a special paper on *Research Needs for Informed Public Policies* which addresses many of the key policy

issues involved in housing the elderly (pp. 8-14, 229-04) and also summarizes a great deal of research that is available to date on the housing and income situation of elderly households.

AFTERWORD

SOME IMPLICATIONS OF THE RESEARCH FOR ADMINISTERING NATIONAL HOUSING GOALS AND LOWER-INCOME HOUSING ASSISTANCE

In 1968, the Congress took the important step of quantifying a set of housing goals for the Nation and required the executive branch to report annually on progress toward those goals.

Six years later, the Congress enacted a new approach to housing assistance for lower-income families, one which provided States and local governments greater program flexibility.

Today, the Congress and the executive branch are faced with the task of bringing these two strong ideas—national goals and local flexibility—together in a consistent national program that can be budgeted, funded and administered in a way that will meet the intents of both the 1968 and 1974 acts. Goals for different kinds of housing activities will have to be established nationally while localities are choosing among different housing assistance programs such as conventional public housing, section 8 new construction and section 8 existing housing. Even when the program mix is known, estimates of the ultimate program costs must live with uncertainties regarding such variables as the future maintenance of the neighborhood, the rate at which the incomes of participants will change and the quality of housing management.

A CONTINUOUS PROCESS FOR SETTING NATIONAL HOUSING GOALS

If national housing goals are to incorporate local conditions, costs and priorities as well as national perspectives, a formal arrangement should be worked out between the Congress and HUD to exchange information about what is happening locally and nationally. The process should be continuous in order to balance locally developed goals and program information such as cost experiences with the national housing goals and budgets.

Furthermore, the process should be "open" so that HUD field offices and the State and local agencies can see the implications of local program decisions for national policy and understand the reasons why a policy is adopted at the national level. It is our perception that a major problem with the Federal system is that confusion results at the State and local level because of the lack of clarity among housing program goals and objectives at the national level. Congress expresses a variety of objectives in committee reports and legislation. Messages go forth from the HUD Central Office as to its views about goals and objectives. Sometimes, individual HUD field offices provided different interpretations of these often conflicting goals to the States and localities. The process of setting national goals should provide for greater clarity and understanding of housing policies at all levels of government.

The national housing goals should also be made more comprehensive. They should incorporate all types of housing activities, not only new construction and major rehabilitation. For example, quantitative targets should be sought for housing conservation activities, repairs and improvements, prevention of housing abandonments in localities where appropriate. Goals might also be conceived for the reduction of the burden of housing costs affecting consumers in various income groups. Other targets could be established for providing housing assistance services, such as homeownership counseling, to groups in the population that do not have the skills to operate effectively in the private housing market.

The Housing Assistance Plans (HAPs) required by the 1974 act potentially provide an excellent vehicle for obtaining State and local needs and priorities. The quality of the HAPs, however, should be upgraded substantially if they are to be used seriously in the process of setting national housing goals. A Federal Government effort to improve their quality should be part of a well-organized program to improve the housing capabilities of State and local governments.

IMPROVING LOCAL CAPABILITIES

A national policy of providing local flexibility in attending to the housing needs of lower-income families will only work to the extent that States and localities are able to make good use of their responsibility. While the quality of local decisions should improve with additional experience in implementing the 1974 act, the rate of progress could be accelerated through a vigorous effort to educate State and local governments about the workings of housing markets and to transfer successful local experiences in improving housing conditions facing lower-income households.

As the accompanying description of the Urban Institute research shows, local decisionmakers need to understand the indirect effects of their housing actions, for example, on the maintenance of housing stock not involved in the housing program and on housing prices throughout the community. In one housing market a program of new construction may lead to abandonment of sound housing elsewhere in the city while in another market a program of new construction may be a necessity both to prevent undesirable price effects and also to assure participation by eligible households. A substantial body of housing knowledge is being accumulated which is not being distributed to State and local governments.

Similarly, experience being obtained by localities is not being shared sufficiently. Encouraged by the 1974 act, many communities seem to be creating new approaches especially in the area of housing conservation, but this wealth of experience only gets transferred in haphazard ways to other communities. Mounting a sustained national effort to transfer the "best practices" of localities is not easy. It is extremely difficult to evaluate local programs objectively, and it is hard to identify the conditions that have enabled the program to work in one place and that might be required to allow it to work in another community. But it can be done.

In short, a major new national effort should be undertaken to improve the administration of housing programs at the State and local

level. The two principal components of this effort would be the distribution of easily-understood descriptions of housing research and the national dissemination of the "best practices" of State and local housing program administrations.

INCREASING HUD MONITORING AND EVALUATION

Housing programs have suffered from "light switch" publicity: Either they are "on" and called a success because of the large numbers of dwellings they produce, or they are termed failure and shut "off". In reality, all housing programs have been outstanding successes in some communities, have been dismal failures in others and have been somewhere in between in most. Because of a consistent failure to evaluate the programs objectively, however, the true distribution of successes and failures in America's communities is never known, and the popular image of housing programs is unfairly cast in the picture of Pruitt-Igoe and its equivalents.

We urgently need to develop, therefore, an objective program of monitoring and evaluating housing assistance for lower-income households. The evaluation program should be able to portray the degree of success and failure throughout many communities as well as being able to identify exemplary program accomplishments on the one hand, and to identify program abuses on the other.

The monitoring and evaluation system should be able to distinguish among problems stemming from program management, external conditions such as economic recession, and bad program design. It should percolate only the most critical information to the top—to the leadership in the executive branch and in Congress. It should afford a way to compare program accomplishments to the improved set of national housing goals. Above all, it should provide for the speedy flow of information so that prompt administrative and legislative action can be taken to correct problems before another national housing program is brought to trial and termed a failure on the basis of a relatively few community abuses.

In summary, the block grant approach, explicit in the Community Development Block Grant program and implicit in section 8, creates new demands for goal-setting, information transfer and monitoring and evaluation. The approach makes sense, however, as the research of the Urban Institute defines the many-sided diversity of local housing conditions.

The need to provide local program flexibility stems from the growing recognition that local housing markets and conditions differ substantially and that no one federally prescribed program would fit the rich variety of local housing conditions. The goals of housing programs to meet the needs of lower-income families are complex, but if they are made specific, if they are properly understood at the local level, and if progress toward them is objectively evaluated, housing programs can be administered successfully.

THE REHABILITATION AND REVIVAL OF DECAYED OR DECAYING RESIDENTIAL NEIGHBORHOODS

(By M. Carter McFarland¹)

Before beginning an analysis of the character, problems, and potentials of residential rehabilitation, it is necessary to make some important distinctions. We must identify what residential rehabilitation is, as generally used, and what it is not.

Every year from \$15 to \$20 billion is spent by property owners to maintain, repair, and improve the Nation's huge existing housing stock. These expenditures cover normal property maintenance (estimated to amount to about 2 percent of the cost of the average dwelling unit), as well as improvements and extensions. They include such things as painting, plumbing and heating repairs, new roofs, new siding, new carports, extra rooms or porches, and a host of related items. This is a highly desirable activity, but it is carried out spontaneously by property owners who can afford it or who can command short-term installment credit to pay for it. This improvement of residential properties, largely by middle- and upper-income families, is not what we call neighborhood rehabilitation. There is another spontaneous process that must be excluded from the definition. This is the occasional dramatic revival of rundown neighborhoods by well-to-do families prompted by the charm of the original buildings or their locational advantages. This is sometimes called prestige rehabilitation. It has occurred in Boston, San Francisco, Philadelphia, and in the Washington area in Georgetown, Alexandria, and on Capitol Hill.

Residential rehabilitation, as used in this report as well as by Federal, State, and local governments, means efforts to arrest the decay cycle that afflicts many neighborhoods (particularly in the inner city) and in which all the natural forces—physical, economic, social, and political—conspire to induce and reinforce further decay. This type of rehabilitation attempts to revive such neighborhoods for the people—largely poor—who live in them by improving their housing, their neighborhoods, and the people themselves.

INCREASING EMPHASIS ON NEIGHBORHOOD REHABILITATION

While public efforts to generate the rehabilitation of decayed or decaying residential neighborhoods are not new (they go back over 40 years), the public and private priority being given to such efforts has increased markedly in recent years. This is reflected in the great emphasis placed on rehabilitation by HUD Secretary Carla Hills in her speeches, congressional testimony and in other policy pronouncements. Robert C. Embry, Jr., Baltimore's Commissioner of Housing and Urban Development, stated in recent testimony before the House Committee on Banking, Currency, and Housing, that: "Persons concerned with housing have increasingly realized that the answer to the problem of urban housing is to be found primarily in the existing

¹Dr. McFarland, a 30-year veteran of HUD and its predecessor agencies, was FHA Assistant Commissioner for Programs in the 1960's and, under Secretary George Romney, FHA Assistant Commissioner for Rehabilitation. He played a leading role in the reevaluation of urban renewal rehabilitation and directed most of the FHA experiments in rehabilitation. He also conceived and directed Project Rehab. All are described in this paper.

stock of housing as opposed to new construction * * * methods of preserving our cities' existing housing will become increasingly important." The platforms of both the Republican and Democratic parties in the 1976 Presidential election disagreed in a number of ways on housing. But both parties agreed on the major priority to be assigned to the rehabilitation of rundown housing. HUD is taking a number of initiatives to encourage residential rehabilitation. So are many State and local governments.

Recent trends in population (as reported by the Census Bureau) support this increased emphasis on neighborhood preservation. In commenting on these trends, Dean Harvey Perloff, of UCLA's School of Architecture and Urban Planning, has said: "We are now a mature nation. The farm-to-city migration is behind us. We are a nation of urbanites. The cities and towns we have already built will be with us for a long time to come. We will have to learn to conserve, to rehabilitate, to revitalize what now exists."² William Gorham and Nathan Glazer have looked at the same statistics and reached this conclusion: "* * * a much more complex housing-related problem [has] emerged—the problems of neighborhood. Housing is more than shelter. It is fixed in a place in a neighborhood. The place and the neighborhood supplement the shelter of the house by meeting other needs and desires: personal security, information, access to jobs, credit, friends, as well as standard public services. It is infinitely more *difficult* to improve neighborhoods than it is to improve shelter"³ (emphasis added).³ The shift in sentiment toward rehabilitation also reflects a rather general disenchantment, particularly among neighborhood residents themselves, with the bulldozer approach to urban renewal which may have increased inner city tax revenues but at the expense of the displacement of thousands of poor people and the destruction of entire neighborhoods. Beyond that, one of the implicit objectives of slum clearance and redevelopment—to attract the middle class back to the city and to disperse the poor to the suburbs—did not work. Neither did later efforts toward dispersal of the poor and black into the suburbs. On the contrary, the concentration of the poor and the blacks in the central city has increased. Thus, it appears unlikely that this important objective—the dispersal of the poor and the racial integration of our urban areas—will be achieved for a long time. In the face of these hard facts, the idea of improving neighborhoods where the poor (and many minorities) now live becomes both a realistic and desirable option. Another consideration arguing in favor of neighborhood rehabilitation and revival, as opposed to rebuilding, is that it is less costly. We will discuss this in more detail later.

THE PROCESS OF NEIGHBORHOOD DECAY

Because this discussion concerns efforts to arrest and reverse neighborhood decay, we must take a close look at this unhappy process. The decline of urban residential neighborhoods is many-sided. It has physical, economic, social, and political elements, all interacting in

² Harvey S. Perloff, editor, "Agenda for the New Urban Era," American Society for Planning Officials, Chicago, 19-5.

³ William Gorham and Nathan Glazer, editors, *The Urban Predicament*, the Urban Institute, Washington, D.C., 1976.

such a way as to reinforce one another. Over 20 years ago Harvey Perloff described the characteristics of decay in Chicago's Hyde Park-Kenwood Neighborhood. He identified these as the key manifestations:

1. Physical deterioration of properties by reason of age, inadequate maintenance, and misuse;
2. Increasing obsolescence of homes, community facilities, and street patterns;
3. Overcrowding of buildings through conversion of existing residences into smaller housing units coupled with a general shortage of educational, recreational, parking and other facilities due to the increase in population density;
4. A general increase in crimes against persons and property related to the general neighborhood decline;
5. A breakdown in the enforcement of building and zoning laws and the lowering of standards in the provision of public facilities and services;
6. An accelerated immigration of low-income families and an exodus of higher-income families, with a corresponding lowering of building maintenance and general community tone and morale.⁴

To make the picture complete, and to reflect significant changes which have occurred since Perloff wrote these words, some additional symptoms of neighborhood decay must be mentioned. These are:

1. *Redlining*.—This term means the near-universal boycotting of declining neighborhoods by normal sources of financing for the purchase and repair of residential structures. As a result of this vacuum of normal financing, owners in declining neighborhoods typically become the victims of loan sharks who exact exorbitant terms for financing. It is not uncommon in declining neighborhoods to find properties saddled with short-term, high-interest-rate debt, expensive second mortgages or purchase contracts under which the title to the building does not actually pass to the purchaser. Redlining has been much discussed and deplored in recent years. Much of this discussion, however well intended, has oversimplified the problem. The absence of normal financing certainly places an added burden on residents of declining neighborhoods. At the same time, the facts of decay make loans in such neighborhoods very risky. There is a limit to how much risk a lending institution can be expected to take, given its obligations to its depositors.

2. *Poverty*.—As several people with intimate knowledge of declining neighborhoods recently told the House Committee on Banking, Currency and Housing, a pervasive characteristic of decaying or decayed neighborhoods is poverty. People in these neighborhoods simply do not have enough income to pay for decent housing or for adequate rehabilitation of the housing they occupy. James Pickman, Vice President of New York's Bedford-Stuyvesant Corp., made this point clearly. He said median income of families in the Bedford-Stuyvesant neighborhood is \$7,000. This income makes it possible to pay about \$145 a month for rent. But 25 percent of the area's residents earn less than \$4,000 per year. Thus, one-quarter of the neighborhood's

⁴ Harvey S. Perloff, *Urban Renewal in a Chicago Neighborhood. An Appraisal of the Hyde Park-Kenwood Renewal Program*, Hyde Park Herald, Inc., Chicago, 1955.

residents cannot afford more than \$83 per month for rent. A rehabilitated dwelling (total cost of property plus rehabilitation is \$25,000) if financed with a normal bank loan will require a rent of \$366 a month. Even at a 3-percent interest rate, the rent on such a rehabilitated unit would amount to \$256 a month.⁵ It would be possible to debate Mr. Pickman's statement on financing costs and resulting rents. This would vary with the mortgage terms available, the interest rate, et cetera. But his basic point is accurate. Clearly, these families need some kind of help to improve their housing. With construction and operating costs rising rapidly, the prospects of families with such low income will become worse. This case is not atypical of costs and incomes in the declining areas of our cities.

3. *Abandonment.*—The large scale abandonment of properties in declining neighborhoods is a recent, growing and disturbing phenomenon. This complicated development is not yet fully understood. But it certainly has much to do with low income, poor property maintenance, flight from poor neighborhoods of all who can afford to do so, low returns to landlords who thus suffer unprofitable investments, landlord-tenant frictions, and other factors. Many run-down neighborhoods are now further blighted by row upon row of boarded up, vacant dwellings. This disturbing new development adds one more potent force to the many involved in neighborhood decay. It also modifies the long-held view (expressed by Perloff in the passage cited above) that neighborhood crowding contributes to urban blight. This is now clearly not so with regard to the number of dwelling units occupied. Indeed, many blighted neighborhoods now have very low population densities as well as underutilized schools. (It is still likely that too many persons are crowded into the units which remain occupied.) One of the curious anomalies of abandonment is that it is not always the worst buildings that are deserted. Much good housing is abandoned. Of course, it does not stay in good condition long because vacant houses invite vandalism, surreptitious use by dope addicts, youth gangs and others.

The lethal effect of widespread abandonment on run-down neighborhoods is not helped, according to the testimony of many city officials and neighborhood residents, by HUD's slowness to repair or demolish thousands of foreclosed and vacant units it owns in declining residential areas, the result of its unhappy experience with subsidized and nonsubsidized housing in the early 1970's. Thus, HUD finds itself in the curious position of appearing to contribute to the blight of the very neighborhoods in which it is encouraging rehabilitation. Of the 2,000 vacant buildings in the Bedford-Stuyvesant area of New York fully one-third are owned by HUD. In Philadelphia, HUD owns most of the vacant units in six declining neighborhoods. Several neighborhood groups recently charged HUD with shifting its responsibility for rehabilitating these HUD-owned units to others. HUD's slowness in repairing its acquired slum properties is, of course, a minor factor in the impact of abandonment on slum neighborhoods.

4. *Unemployment.*—Unemployment is well-known to be disproportionately high in blighted, inner-city neighborhoods, especially

⁵ Statement by James Pickman, Vice President, Bedford-Stuyvesant Restoration Corp., before House Committee on Banking, Currency and Housing, Sept. 22, 1976.

among the young. This highlights the direct relationship between the intensity of urban blight and the state of the economy in general. Idleness among the young certainly contributes to the youth gangs whose mindless acts of violence—murder, rape, mugging—spread fear throughout their own blighted neighborhoods and beyond. The high rates of unemployment among youth appear likely to increase because the proportion of the young in the total population will grow. However, a high rate of unemployment in general is not the only factor at work. Even in good economic conditions, ghetto youth find it hard to find a job. Beyond that, many of them would be reluctant to take a job if it were available because they find illicit activities more appealing and even more profitable than the jobs for which they are qualified.

5. *Crime*.—Harvey Perloff's analysis of the causes of decay in Chicago's Hyde Park-Kenwood neighborhood, made over 20 years ago, identifies crimes against persons and property as one of the important symptoms. Since that time, the crime rate has increased so dramatically as to give an entirely new dimension to this ominous aspect of blight. Indeed, many such neighborhoods are today called jungles. Much of this violence is committed by young people and it is, too often, inflicted on residents of the neighborhoods in which the youth reside. Crime contributes significantly to what can be described, without exaggeration, as a kind of urban anarchy. That much-respected student of urban affairs, Anthony Downs, refers to such neighborhoods as "crisis ghettos."⁶

6. *The culture of poverty*.—In recent years, we have come to see more clearly, if not to understand, another disturbing characteristic of many blighted, inner-city neighborhoods. This is the existence of some families and individuals, perhaps a small percentage of the total, who appear to be incapable of or uninterested in responding to all efforts to help them. Edward Banfield has called this the culture of poverty. It is, he speculates, characterized by an almost complete psychological preoccupation with the immediate present. Thus, such a person is unable to plan or in any way to "invest" his efforts in the future. Because of this, he is uninterested in a permanent job, but only in acquiring, legitimately or otherwise, enough funds to satisfy his immediate appetites for food, for drink, or for dope. He is also uninterested in education, job training or any other activity that represents an investment in future improvement. This poverty culture, according to Banfield, also displays strong tendencies toward drink, toward violence, toward neglect of family responsibilities and child training. Banfield argues that these characteristics are not related to race, although many poor minority families display them, but to a cultural training and inheritance. He observes that, in the last century, many immigrant groups, particularly the Irish, displayed the same characteristics. He thinks that no governmental actions can change these cultural characteristics but only time will cure them. Many disagree with Banfield's analysis, without denying that the behavioral characteristics exist. Patrick Moynihan, in a much discussed paper written in the 1960's, attributes this behavior to the dissolution of the black

⁶ Anthony Downs, *Opening Up the Suburbs*, Yale University Press, New Haven, 1974.

family caused by years of slavery. The 1970 Census statistics, which show a high percentage of women-headed families in poverty and slum areas, would seem to support Moynihan's thesis. However, Herbert Gutman's recent book, *Black Family in Slavery and Freedom 1750-1925*, raises questions about the notion that slavery destroyed the black family structure.

The administrators of the public housing program, both in this country and in England, refer to the type of family we are discussing as "nonupward mobile," without giving an analysis of why such behavioral patterns exist. But the public housing experience provides conclusive evidence that the presence of a critical mass of such families in a large project can produce the same patterns of crime, vandalism, irresponsibility and so on, that Banfield identifies—behavior patterns that can and do turn well-built and well-designed housing into a jungle. The now infamous Pruitt-Igoe public housing project in St. Louis is the best known, but by no means the only, example. If the presence of a sufficient number of nonupward-mobile families in a public housing project can ruin it, there is every evidence that the same thing happens in some blighted, poverty-ridden neighborhoods, no matter how much the houses themselves are improved. If we do not clearly understand what causes this antisocial, disruptive, and violent behavior, we do know that it exists. It is a puzzling, serious, and solution-defying aspect of contemporary urban America.

A BRIEF HISTORY OF REHABILITATION

The idea, or the dream, of rehabilitating run-down residential neighborhoods is not new in this country. It is nearly 40 years old. In 1940 the Home Owners Loan Corporation (HOLC) published a study entitled "Waverly—A Study in Neighborhood Conservation." It was a remarkably perceptive and prophetic analysis of the problem and represents a significant landmark in the quest for a valid approach to rehabilitation in neighborhoods infected with the virus of decay. The Waverly report, which was ahead of its time, was based on an HOLC study of the problems and prospects for rehabilitation of a residential area in Baltimore, Maryland in which the agency held mortgages on a number of properties.

The Waverly report showed awareness of the need to approach residential rehabilitation in declining areas on a neighborhood basis, as well as the need for property owner organization and leadership. It also recognized the need for public action to enforce zoning and codes, and to provide the necessary public improvements. The conception of a successful neighborhood rehabilitation program reflected in this pioneering study is strikingly similar to the approach which became standard in the Federal Urban Renewal program 14 years later and was still being followed by many localities in 1976. The Waverly study summarized the essential ingredients of successful residential rehabilitation thus:

For maximum and assured success, action must be undertaken as a united community enterprise, based on a broad, carefully planned and therefore relatively costly pattern which embraces the district as a whole and each dwelling in it. If it is to be gen-

uinely effective, the pattern must be developed under experienced technical guidance; must include detailed recommendations for repair, modernization, and embellishment by the owners, of all residential units which need rehabilitation or architectural revision; must directly or indirectly provide a financing medium, easily and cheaply available to those who cannot themselves supply the funds necessary to defray the cost of such repair and reconstruction must deal with community problems such as opening and closing of streets, the establishment of recreation areas, and the voluntary acceptance by property owners, of those use and ownership restrictions not related to zoning and not usually covered by ordinance, which have so frequently been found to constitute actual benefits to the individual owner and his neighborhood; must devise barriers against infiltration by undesirable residents and encroachment and infection by contiguous substandard districts; must provide for traffic routing and regulation; must consider necessary extensions of school equipment and the adequacy of public utility and transportation facilities; must plan landscaping for public and private spaces; and, finally, in both its initial and subsequent stages, must be administered under sympathetic and continuously energetic leadership.

A little later, some efforts were made locally to carry out a comprehensive concept of neighborhood rehabilitation, combining property owner organization and leadership with a blend of public and private action. The Baltimore plan is, perhaps, the best known. It combined systematic block-by-block code enforcement in blighted neighborhoods with counseling and guidance to property owners and tenants and efforts to deal with acute financing problems. A private Fight Blight Fund was created to provide financial counseling and easy credit to help solve the problems of families least able to afford the desired rehabilitation. Another contribution which Baltimore made to the concept of residential rehabilitation was the establishment of a special housing court to handle code violations in a manner at once sympathetic to the rehabilitation objectives of the city and to the problems faced by the poor in complying with code violation notices. This approach to housing code enforcement was to be much applauded in other cities and sometimes imitated.

The Back of the Yards rehabilitation effort in Chicago was another pioneering effort which attracted much attention. In the Back of the Yards area, indeed, the physical rehabilitation of properties followed some years after the Back of the Yards Council had demonstrated dramatically how a run-down, crime-infested neighborhood could organize itself, create remarkable neighborhood morale and unity, tackle crime, juvenile delinquency, domestic budgeting, and a host of other social problems. More than anything else, the back of the yards is a striking case of grass roots democracy and community self-help.

URBAN RENEWAL REHABILITATION

Beginning in 1954, as a result of amendments passed during the administration of President Eisenhower, the Urban Renewal program was broadened to include the preventative medicine of rehabilitation with the surgical remedies of slum clearance and redevelopment. This law—plus subsequent additions—made the following forms of assist-

ance available to localities for neighborhood rehabilitation under the Urban Renewal program.

1. Grants for project planning, for staff to assist and counsel property owners in rehabilitating their buildings, for enforcement of codes, for spot clearance where needed, and for the installation of various types of neighborhood facilities.

2. Loans and grants under section 312 to assist property owners to finance their rehabilitation efforts—before the section 312 program was enacted in 1964 localities were expected to rely for financing on a special program of FHA-insured rehabilitation loans.

In 1964 the Urban Renewal authority was further broadened to provide assistance for local programs of concentrated code enforcement. This program was designed to assist neighborhoods in which blight was not far advanced and where the enforcement of codes plus a minimum of public improvements could nip the decay cycle in the bud. This might be called slum prevention while urban renewal rehabilitation was designed to revive areas more deeply affected by decay. The Federal aids provided for concentrated code enforcement were essentially the same as those provided for rehabilitation.

During the over 18 years the urban renewal rehabilitation programs were in existence (from 1954 to the moratorium announced in 1973) there were about 900 rehabilitation projects in HUD's workload, containing nearly 500,000 dwelling units. However, on only about 180,000 of those units was the rehabilitation completed. This amounts to the rehabilitation of an average of about 10,000 units a year, with a somewhat higher annual figure in the later years, not an impressive volume in light of the Census Bureau's very conservative count of 7 million substandard units in the United States in 1970. A study by the Harvard-M.I.T. Joint Center for Urban Studies, partly funded by HUD, found that 13 million households were living in substandard housing or paying an excessive proportion of their income for the rent, and even this figure, by their own admission, failed to take into account one very important factor in the measure of substandardness.⁷

The concentrated code enforcement program, in existence for a little over 9 years, produced 233 projects with about 250,000 units reported as repaired to code standards, or about 27,000 a year.

There are a number of reasons for this relatively unimpressive performance in neighborhood revival under the Urban Renewal program in contrast to the vastly larger amount of activity in slum clearance and redevelopment. This does not mean, of course, that more housing for low-income families was produced through redevelopment. Three factors seem most significant. First, neighborhood rehabilitation is complex and difficult—considerably more so than clearance. Second, there was a serious absence of capable, well-trained staff to carry out the program in the neighborhoods. Lastly, until 1965 or even later, rehabilitation was not high on the priority list of local officials responsible for the urban renewal activities. Local interest in rehabilitation grew as disenchantment with and public resistance to the "bulldozer" became widespread.⁸

⁷ *America's Housing Needs: 1970 to 1980*. Joint Center for Urban Studies of the Massachusetts Institute of Technology and Harvard University, Cambridge, 1973.

⁸ The substance of these paragraphs is taken from an analysis of government-supported residential areas prepared in 1974 for the National Bureau of Standards by the author of this article.

FHA REHABILITATION EFFORTS

In the early 1960's, the Federal Housing Administration—FHA—began to direct its financing programs (including its recently enacted subsidy programs) and its know-how toward the difficult problem of residential rehabilitation in inner city neighborhoods. Two motives prompted these actions. First, FHA had received considerable criticism in the 1950's for its failure to support the Urban Renewal program by making insured mortgage financing, specially designed for this purpose, available for residential construction on land cleared by urban renewal activities. This criticism was, to a considerable extent, justified. When Robert C. Weaver was appointed Administrator of the Housing and Home Finance Agency in 1961, he was determined to change this situation, as were the two men he appointed to head the FHA in 1961 and 1963. Second, Weaver and his FHA Commissioners saw that the FHA, long concerned almost entirely with suburban construction, must direct its efforts toward the urgent problems of poverty and neighborhood decay in the central cities.

The first FHA initiative, begun in 1961, was a joint effort with HHFA's Urban Renewal Administration and the Baltimore Urban Renewal and Housing Agency—headed by Richard L. Steiner, formerly HHFA's Urban Renewal Commissioner in the Eisenhower Administration. It took place in a long bogged-down urban renewal rehabilitation area in Baltimore known as Harlem Park. It was designed to establish patterns of cooperation among the three agencies, and to get at the roots of the problems which were then inhibiting progress in urban renewal rehabilitation all over the country. It was a joint learning process. Much was learned and the results were many. (What we have learned will be discussed later in detail.) A new understanding was gained of the fundamental processes that seemed to be required for successful neighborhood rehabilitation. These understandings led to basic changes in the procedures used by the Urban Renewal Administration, and to the development by FHA of completely new physical standards for use in urban renewal rehabilitation areas and the issuance of an FHA Handbook outlining procedures to be used by FHA field offices in supporting local rehabilitation efforts under the urban renewal program.⁹ HHFA Administrator Robert C. Weaver said of the Baltimore effort: "It has provided us with badly needed insights, knowledge and skills for carrying out some of our most important responsibilities."

One of the many lessons learned from the Harlem Park experiment was that the urban renewal approach to rehabilitation (which was quite similar to that initially described by the HOLC in 1940) was more effective in dealing with owner occupants in rundown areas than with absentee-owned properties. In many decayed neighborhoods from 50 percent to 75 percent of the properties are owned by absentee landlords. This prompted the FHA to undertake a series of rehabilitation experiments in dealing with absentee owned properties. There is space only to list briefly some of these experiments.

⁹The lessons of this experiment were published by HHFA in a booklet, "Residential Rehabilitation in the Harlem Park Area," by M. Carter McFarland, 1962. A more thorough report on rehabilitation experience through 1965 can be found in McFarland and Vivrett, editors, "Residential Rehabilitation," University of Minnesota, Minneapolis, 1966.

1. *New York's 114th Street.*—This experiment, carried out by FHA and the city of New York, involved the purchase by a nonprofit foundation of an entire block of buildings on 114th Street in Harlem housing 1,600 people and their rehabilitation under two FHA below market interest rate mortgages. The work was done by one of the largest builders in New York City. The rehabilitation was done in series in order to avoid permanent displacement of any family. Social services were supplied under a grant from the Office of Economic Opportunity. The buildings were typical New York old law tenements. They were purchased at a cost of between \$2,000 and \$3,000 per living unit. Rehabilitation costs averaged about \$11,000 a unit. The FHA loan was at a 3-percent interest rate with rent supplements added for many of the structures to bring the rents down further. Thus, many of the families were in the public housing income brackets—the poor.

2. *Maremont Foundation, Chicago.*—FHA collaborated with and provided financing for the purchase and rehabilitation of a number of moderate-sized apartment structures in rundown sections of Chicago. FHA put a special team of appraisers, architects and other experts in its Chicago office to provide guidance and speedy processing of applications for financing. The structures were walkup apartment houses of moderate size scattered rather widely. They were not badly deteriorated and were in relatively good neighborhoods. Here, the families to be served were above the poverty level and the rehabilitation required was moderate.

3. *National Gypsum Co.*—Stimulated by FHA's activities and by the obvious market for building materials which would result from successful mass rehabilitation, the National Gypsum Co. acquired several tenement buildings in New York City and rehabilitated them with its own funds to gain experience with materials and methods, as well as with the social requirements of doing work of this kind. The company followed with a few additional structures, using FHA financing. Their hope was to demonstrate the feasibility of residential rehabilitation to other entrepreneurial groups and, thus, to generate a market for their products. That hope was not realized to any substantial degree.

4. *"Instant" rehabilitation.*—FHA concluded that an effort should be made to improve the technology of rehabilitation and to speedup the process. This would reduce both costs and the time the families would have to be displaced while the work was in process. A systems engineering firm was persuaded to apply its skills to the problem. FHA provided mortgage financing and IHHFA made a demonstration grant. After considerable preparation, two New York tenement buildings were actually rehabilitated completely in just 48 hours. The methods used were novel and dramatic and aroused much public interest. Like many such efforts to improve building technology, the process was not repeated. The cost per unit was very high, due to the quite innovative nature of the rehabilitation and the extensive advance preparation required. The reasons the method was not repeated were the initial high cost and the more basic fact that no way has yet been found to aggregate a sufficient market to make an industrialized building system competitive with more conventional methods.

5. *Allegheny Housing Rehabilitation Corp.*—Action Housing, Inc., a business-supported nonprofit organization in Pittsburgh, carried out

the rehabilitation of a block of dwellings with FHA below market rate financing. So impressed was Pittsburgh's business community with the results, that it created a special profitmaking corporation devoted entirely to the purchase and rehabilitation of rundown rental units in Pittsburgh. As this corporation—AHRCO—gained experience it was soon producing well over 500 rehabilitated units a year. Its activities continued to grow until the 1973 moratorium on housing subsidy program was announced. The structures rehabilitated by AHRCO were mostly rowhouses in the Homewood-Brushton neighborhood. They were acquired for prices ranging from \$3,000 to \$5,000 per unit. Rehabilitation costs ranged from \$14,000 to \$18,000. Most of the rehabilitation was financed under FHA's section 236 program which provided an interest rate as low as 1 percent. Rent supplements were also used for some units to further lower the rents. Thus, the income levels served were the poor (public housing eligibility) and some slightly above that level.

6. *BURP*.—In Boston, FHA entered into arrangements with a number of experienced rehabilitation contractors to produce, in 1 year, over 2,000 rehabilitated apartment units. One top FHA official spent at least half of 1 year in Boston spearheading this demonstration of fast, mass rehabilitation. It was called the Boston Urban Rehabilitation Program. The structures rehabilitated were modest sized walkup apartments. Acquisition cost per living unit was about \$3,000 and rehabilitation costs ranged from \$8,000 to \$11,000. The work was done by five or six profit-motivated contractors who also managed the units after rehabilitation. The families served were the poor and near poor.

PROJECT REHAB

On August 19, 1969, HUD Secretary George Romney, in a memorandum to all Assistant Secretaries, Regional Administrators and other principal staff, announced that: "The Department will undertake to generate and support large-scale rehabilitation of absentee-owned residential properties in a number of selected cities throughout the country. All the resources and programs of the Department will be brought together in support of this effort." This effort became known as Project Rehab. In conception and design, it would attempt to do the same for rehabilitation that Romney's Project Breakthrough would attempt in the field of housing technology. It was essentially an effort to duplicate in a number of cities what has already been stimulated in Pittsburgh and Boston. The goal was to stimulate the rehabilitation of 37,500 units over a 2-year period in 15 cities. As the project gained momentum, the initial goal was increased. By the time Project Rehab was interrupted by the 1973 moratorium on all housing subsidy programs, 30 cities were involved and 51,000 housing units were targeted for rehabilitation.

There was no single pattern by which Project Rehab was carried out. In fact, the diversity of arrangements was striking. In Pittsburgh, AHRCO (mentioned earlier) became the focus of Project Rehab activity, because it was already geared up to take care of the various essential elements. In Cincinnati, on the other hand, the effort was carried out by scores of very small, mostly nonprofit sponsors.

In Detroit the job was done by a group of black sponsors and contractors with strong support and guidance from the Michigan State Housing Finance Agency. In Hartford, the work was undertaken principally by the Hartford Development Corp., a private, business-supported nonprofit organization. In Philadelphia, Baltimore, and El Paso, the principal moving force was the local housing or redevelopment authority. In New York the team consisted of a Boston-based rehabilitation entrepreneur, a savings and loan association which made the properties available from its foreclosures at a favorable price, as well as neighborhood model cities leaders.

The Detroit effort, to choose one for illustration, involved the purchase and rehabilitation of a number of walkup apartment structures containing about 3,000 units. The acquisition cost ranged from \$3,000 to \$4,000 per unit. The cost of rehabilitation was from \$8,000 to \$11,000 per unit.¹⁰

By the end of 1972, about 26,000 of the goal of 51,000 units had been rehabilitated. Because a year was spent negotiating with cities before actual production started, this means that the annual rate of production amounted to about 17,000 units. The Secretary of HUD expressed great satisfaction with the results. The Arthur D. Little Co., which evaluated the Project Rehab experience under contract with HUD, concluded that Project Rehab "had proved that massive rehabilitation can be accomplished." Both judgements were premature because the success of residential rehabilitation depends not only on the number units completed, but on the long-term improvement of the housing, the living conditions of the people affected, and conditions in the neighborhood.

LONG-TERM RESULTS OF FHA'S EFFORTS

An evaluation of some of the rehabilitation efforts described above from 7 to 10 years after, is instructive. It shows both the difficulties and the promise of rehabilitation. For this purpose, the writer has examined in some detail projects in four cities.

New York.—The FHA-initiated rehabilitation experiment in Harlem's 114th Street was started about 10 years ago. The FHA mortgages financing this experiment were foreclosed and the properties acquired by FHA several years ago. Recently, FHA sold the properties at a substantial loss. The effort clearly was not a financial success, principally because of inflation in the costs of utilities and management as well as very high expenditures required for property maintenance and repair. Heating furnaces and similar equipment broke down and had to be replaced. All this produced operating costs which could not be passed on to the low-income tenants and could not be covered by increasing the FHA subsidy due to limitations in the laws under which it was financed. However, despite the fact that it was located in one of the worst slums in New York, most of the tenants did maintain their apartments well and enjoyed considerably improved housing. On the other hand, Old Law Tenements are not considered by those involved to be physically well-suited for rehabilitation. The fourth floor apartments in these walkup buildings proved to be hard to rent.

¹⁰ The property acquisition and rehabilitation costs cited are those which existed from 7 to 10 years ago. Rehabilitation costs would certainly be much higher today. Property acquisition costs may be greater or not depending on the neighborhood chosen.

More important, the single block of rehabilitated dwellings was surrounded by a slum with its violence, dope addiction, and other anti-social behavior. Thus, it cannot be said that the 114th Street experiment improved the neighborhood. Rather, the character of the surrounding neighborhood engulfed the project making it as dangerous a place in which to live as before the rehabilitation began. Under these circumstances it is remarkable that the tenants maintained their properties as well as they did. Clearly not all families living in bad slums are irresponsible and beyond reach. This experiment seems to have proved three things. A small rehabilitation project in a sea of deep slums has little chance of improving a whole neighborhood. Also careful attention must be paid to the physical suitability for rehabilitation of the properties chosen. Many families, even in bad slums, are responsible and will respond to rehabilitation.

Pittsburgh.—One of the most innovative aspects of FHA's Pittsburgh rehabilitation experiment was the creation by the business community of a special profit-oriented corporation—AHRCO—to specialize in the purchase, rehabilitation, and management of rundown rental structures. The hope was to demonstrate that slum rehabilitation could be profitable business with help of the FHA subsidy programs. AHRCO developed some new rehabilitation techniques, trained minority contractors to do the work and developed people skilled in project management. Despite all the skills and businesslike management applied to the enterprise, the mortgages on practically all of the structures rehabilitated by AHRCO were foreclosed and assigned to FHA, nearly 1,800 units. It could not, then, be concluded that the effort proved profitable, as hoped. AHRCO's training of minority contractors was a positive contribution. Viewed about 9 years after it started, the response of the affected families to their improved homes varied. Some maintained their properties and were responsible renters. Others were not—they failed to keep their properties in good condition and neglected to pay their rent. The reasons for the economic failure included rent delinquencies, poor property maintenance on the part of some, escalating management and repair costs which could not be covered by the subsidies available and defects in AHRCO's rehabilitation techniques which made the properties more susceptible to normal wear and tear than they should have been. After 9 years, the experience is mixed. A good deal was accomplished, several thousand families were given better homes and many minority contractors and workers were given training and jobs. On the other hand, the experiment did not prove profitable to the company partly because some families were destructive of their housing and failed to pay their rent and partly because a more flexible and generous Federal subsidy would have been needed.

Boston.—Of the approximately 3,000 units rehabilitated under the BURP program in Boston by profit-motivated contractors, all but those subsidized by rent supplements (a deep and flexible subsidy) have been foreclosed and returned to FHA. Most of the rehabilitated apartments have deteriorated physically because about 15 percent of the tenants allowed their apartments to run down and vandalized the halls and other common areas. As one of the property managers said recently: "It only takes a small percentage of destructive families to ruin an entire project." This small percentage, he said, "Simply don't

give a damn." The neighborhoods in which the rehabilitation took place are, if anything, worse than they were when the rehabilitation started. Nonpayment of rents was general, probably as much as \$1 million of income was lost in this way. With fixed and limited subsidy, the economics of the projects become impossible. The bad behavior of some tenants contributed much to the economic deficits in a project which can only be assessed as a failure. It is also instructive that at least one BURP contractor is still rehabilitating housing, but in much better neighborhoods.

Detroit.—The Detroit rehabilitation activity was carried out under Project Rehab at least 3 years after those discussed above were started. Mortgages covering about 1,200 units have been assumed by FHA. The remainder will probably be returned to FHA soon. But the reasons for this failure are quite different from those which caused the other projects to be turned back to FHA. The rehabilitation in Detroit was carried out in better neighborhoods, vandalism was relatively low and property maintenance was good, with few exceptions. The problem in Detroit was principally a misjudgment of the market. Many one-bedroom apartments were created when the market was for larger units. This led to high vacancy rates and, of course, low income to owners. Also many vacant apartments led to vandalism which would not otherwise have occurred. Also, because FHA cost estimates were very conservative, black contractors recruited to do the rehabilitation all lost money, hardly an inducement to minority enterprise.

CURRENT ACTIVITIES

Since the passage of the 1974 housing and community development law, establishing block grants for community development and section 8 program for subsidizing housing for those who cannot otherwise afford it, neighborhood rehabilitation efforts have taken a different turn, but they have not stopped by any means. HUD's rehabilitation efforts fall into five categories:

1. *Block grants.*—Under the block grant program, initiative has been shifted to the localities. Most localities have given high priority to the rehabilitation. According to HUD, of the \$2.6 billion made available under the block grant program during fiscal year 1976, communities have dedicated more than 60 percent of the physical preservation of declining neighborhoods and for the public services necessary to support these efforts. Over 9 percent of these funds, or about \$230 million, was budgeted directly for housing rehabilitation grants and low-interest housing rehabilitation loans. The National Association of Housing and Redevelopment Officials, which is monitoring the block grant experience, reached a slightly different conclusion. It found that 19 percent of the funds went for housing rehabilitation; of this 11 percent was for rehabilitation loans and grants and 8 percent for rehabilitation of structures carried out directly by the localities.

Many localities are displaying considerable ingenuity in using their block grant funds to devise novel ways to finance rehabilitation. Baltimore; Portsmouth and Norfolk, Va.; Tampa; Hoboken; Boston; Portland, Oreg.; San Antonio; as well as San Diego, Menlo Park, and Torrance in California—all are good examples. A wide variety of arrangements have been developed. These include loans at below-

market interest rates, direct grants to cover part of the rehabilitation cost, and several ways to subsidize the interest rates on loans by private lenders. Often the city pays the difference between the market rate and the lower rate offered the homeowner. Nearly all of these plans are designed to re-create, with block grant funds, low interest rate loans, and grants similar to those which have been available under the Federal Government's section 312 program. Some of the programs are administered by the localities; others by private lending institutions.

2. *Section 312 direct loans for rehabilitation.*—This direct loan program, providing 3-percent interest rates, gave localities \$115 million in fiscal year 1976 to finance rehabilitation activities. Some localities objected to HUD's release of these funds on a quarterly basis, arguing that this made it difficult to plan their efforts.

3. *Homesteading.*—This is a demonstration program with 23 cities participating and more to come, in which HUD conveys to localities at no cost, buildings in inner city areas which it has acquired through foreclosure. In addition, HUD makes available section 312 loans to help owners rehabilitate the structures they have received from the city, at nominal cost. The cities are expected to add their own funds to support the effort either from block grants or raised from other sources. In essence, the homesteading program is one in which families are given houses on the condition they will rehabilitate them to reasonable standards with the help of the low-interest loans available, or with their own efforts, or both.

4. *Urban Reinvestment Task Force.*—This is a program in which HUD cooperates with the Federal Home Loan Bank Board, to bring together the city, community residents, and local financial institutions in a concentrated effort to rehabilitate and improve specific neighborhoods. The essence of the program is the organization of neighborhood groups to help themselves. It is a self-help program now involving 26 neighborhoods in different cities. This program, according to HUD, is modeled on Pittsburgh's Neighborhood Housing Services Program which a HUD-supported evaluation concluded had been quite effective in mobilizing and organizing the capacity and leadership for self-help existing in many neighborhoods. It is worth noting that this Pittsburgh effort is a direct-descendant of earlier neighborhood self-help efforts started in the Homewood-Brushton area, with support from the Ford Foundation. The germs of the idea came from two sources: First, the conviction of Paul Ylvisaker of the Ford Foundation that the agricultural extension idea, so successful in helping farmers, could be applied to rundown urban areas; and, second, the experience of Pittsburgh's Bernard Loshbough, who had seen the concept of community self-help applied to the poor in India. Another matter worth noting is that William A. Whiteside, Staff Director of the Neighborhood Reinvestment effort has said: "The program does not appear well suited to neighborhoods which are characterized by poverty income levels, heavy absentee ownership, severe vandalism, and abandonment." This HUD effort, thus, appears to be best suited to neighborhoods at the early stages of the decay cycle.

5. *Rehabilitation financed under section 8.*—Ten percent of the housing activity for which section 8 rental assistance funds had been reserved to State finance agencies and localities (as of June 1976)

was to support rehabilitation for lower-income families. This would subsidize about 10,000 units. In January of 1977, HUD Secretary Carla Hills announced that an additional \$30 million of section 8 rental subsidy funds had been allocated to 20 cities for rehabilitation demonstrations for lower-income families. Very little of this section 8 rehabilitation has been completed.

State effort.—Through their housing finance agencies and departments of community affairs, many States are taking the initiative in helping localities, through financing and technical assistance, to tackle the rehabilitation of decaying housing. Some States have developed programs which provide low-interest-rate loans and grants to support rehabilitation.

WHAT WE HAVE LEARNED

During the past 15 years or more that Federal and local governments, as well as private enterprise, have been actively involved in neighborhood rehabilitation, much has been learned, although our knowledge is still not complete enough. We can define much better than before the complex nature of rehabilitation; we also understand much better the various tools needed to make rehabilitation work; most important of all, we understand better than before where rehabilitation can work and where it is futile to attempt it. Following are the major lessons we have learned about the elusive art of neighborhood rehabilitation:

1. *Difficulty.*—The rehabilitation of residential neighborhoods is an extremely difficult, complex job requiring great skill. It involves a host of interwoven physical, economic, political and social considerations. All of us who have struggled with the problem can agree with Harvey Perloff when he says that rehabilitation is needed "but it is easier said than done."¹¹

2. *Cost benefits.*—Based on a superficial look, it may appear that the cost of rehabilitation approaches that of new construction. In some cases it does, particularly when a rental unit must be purchased and then rehabilitated. When the unit is owner-occupied, the cost comparison with new construction is more favorable. But direct cost comparisons miss the point. A realistic cost-benefit analysis of rehabilitation compared with new construction must take into account two other important considerations—the total savings resulting from the fact that nearly all the public expenditures for infrastructure—water and sewer lines, streets, sidewalks, and so on—have already been made where rehabilitation occurs. Also, the intangible but very real human values that attach to a neighborhood must be considered. When the complete equation is considered, rehabilitation must be considerably more cost effective than clearance and new construction, or even new construction in the suburbs where the infrastructure must be built and paid for as the houses are constructed.

3. *Homeowners and absentee owners.*—It became clear a number of years ago that the problems involved and the methods required to rehabilitate owner-occupied units are very different from those related

¹¹ Perloff, *Agenda for the New Urban Era*, op. cit.

to absentee-owned rental units. The traditional urban renewal approach (counseling, neighborhood improvements, neighborhood organization, code enforcement, financing for needed repairs) was better suited to owner-occupants than to absentee-owned properties. The same is true of the work of HUD's current urban reinvestment program. On the other hand, Project Rehab was specifically designed to deal with absentee-owned properties, and could not deal with owner-occupied structures, nor could it finance neighborhood improvements as the urban renewal program could. It involved quite different techniques. Ideally, we need a blend of both approaches if we are to deal with all the housing in a typical run down neighborhood.

4. *Economies of scale.*—Experience so far has demonstrated rather conclusively that we can expect no significant economies from a large volume of rehabilitation of the type attempted and partially achieved under Project Rehab or under the method used for homeowners. Each dwelling typically presents its own unique physical problems. Thus, the process has to proceed house by house, or building by building. As Edward Logue, a pioneer in rehabilitation, has said with accuracy, "rehabilitation is the retail side of the renewal business."

5. *Lack of an industry.*—Not the least of the impediments to rehabilitation is the fact that there is no well-developed industry as there is for the construction of new homes. Indeed, the homebuilders of America have shown little or no interest in rehabilitation. Rehabilitation is more uncertain and risky than new construction and most homebuilders are enamored with the smell of new lumber. What we have for the most part is a group of small repair contractors who specialize in roofing, plumbing, electrical work, and so on. Often it is difficult to find a general contractor who will put all these pieces together and deal with the needed rehabilitation on a comprehensive basis. Project Rehab was, among other things, an attempt to develop such an industry. It succeeded only here and there. Beyond that, it is no longer operating, and many general rehabilitation contractors disintegrated. But some still exist and a sustained rehabilitation program would produce more.

6. *Lack of skilled people.*—The rehabilitation of owner-occupied structures requires people with considerable skill in neighborhood organization, homeowner counseling, developing specifications of the work needed, arranging financing, and other related services. Equally complex skills are required for the rehabilitation of absentee-owned structures. These skills are not plentiful. Many more people skilled in the rehabilitation art are needed if rehabilitation is to be accomplished on a scale commensurate with the need.

7. *A one-stop service, particularly for homeowners.*—Neighborhood organization, pep talks, code enforcement, and liberal financing will, of themselves, not make rehabilitation happen, even with homeowners. Notice of code violations is not the same thing as an explicit specification of the work needed to remedy these deficiencies. Also, there is the need to secure a responsible contractor, to inspect the work in progress, to arrange financing, and perhaps to assist in the temporary relocation of the family while the work is going on. It is too much to expect the homeowner to carry out all of these tasks himself. What is needed is a skilled person capable of putting all these elements

together just as a builder does when he sells a new house or a realtor does when he sells an existing house. The lesson was slowly learned in the Urban Renewal program. Under block grants, the more sophisticated cities probably recognize this need. But there is still the need for much training of inexperienced cities and the development of rehabilitation packages with the required skills.

8. *Subsidized financing is needed.*—One of the major reasons for neighborhood decline is poverty. It is unrealistic to assume that rundown neighborhoods can be rehabilitated without subsidies of some kind. From what is currently happening, it appears that most cities recognize this need. The question is whether the rehabilitation needed can be financed and subsidized with the funds available. Experience also shows that the Federal subsidy should be flexible to adjust to escalating management and maintenance costs.

9. *Neighborhood improvements.*—It is not enough to rehabilitate houses in a rundown neighborhood. The physical quality of the neighborhood must be improved. This often involves the creation or improvement of a variety of neighborhood facilities. Also, the municipal services, typically poor in rundown neighborhoods, must be improved. This means public schools, police and fire protection, garbage collection, shopping, and many other things that the Urban Institute has called the package of housing services, many of the most important of which are not provided by the house itself, but by the neighborhood. George Sternlieb, who has studied the phenomenon of abandonment more than anyone else, has said that "the problem today is to revive neighborhoods not just rehabilitate houses."¹² This was understood by those pursuing neighborhood revival under the Urban Renewal program; it was also understood by those responsible for Project Rehab. But in Project Rehab, with rare exceptions, the tools available did not make the improvement of neighborhood facilities and services possible. The need for improving neighborhood facilities and services is often a vital condition to successful rehabilitation.

10. *Rehabilitation standards.*—This refers to the level of physical improvement of housing to be achieved through rehabilitation. This standard is not easy to define and it will probably vary from place to place. Two extremes should be avoided—too little and too much. There can be little question that in the early years of urban renewal rehabilitation when FHA financing was required, FHA demanded standards of physical improvement that were unrealistically high. FHA learned this lesson in the 1960's and developed entirely new rehabilitation standards which were flexible and sought to help local officials to reconcile the desirable with the possible.

On the other hand, it does not follow that bringing housing up to local code standards will be sufficient to provide decent housing. Local codes vary in requirements and in the degree of enforcement. They are also primarily concerned with sanitation, fire protection, safety, and related matters. Rarely do they deal with the adequacy of space for a family of a particular size (overcrowding), storage space, closets, up-to-date kitchens and bathrooms, and many other things that constitute livable housing. They never deal with neighborhood

¹² George Sternlieb, *Residential Abandonment*, Rutgers University, New Brunswick, 1973.

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quality. Just as the Census definition of substandardness, hot and cold running water, other plumbing, dilapidation, et cetera, is now widely recognized, particularly by the Census Bureau itself, to be an insufficient measure of substandard housing, so can local housing codes be similarly misleading and, in some cases, irrelevant. There has been discussion in some quarters of what is called minimal rehabilitation. William Grigsby, in a recent book,¹³ covers this idea. He identifies one level as paint-up/fix-up, costing, in 1969 prices, about \$1,000 per unit. "Minor rehab" is priced at \$2,500 per unit. But a careful reading of his discussion discloses that he is not advocating a substantial lowering of rehabilitation standards. Rather, he is referring to that part of the housing stock which is only moderately, or slightly, run down, and thus will require less work to bring it up to whatever standard is chosen. It goes without saying that some inner-city houses need less rehabilitation than others. Some need very substantial or gut rehabilitation; others need much less. Grigsby goes on to say that most of the houses he has in mind are not in urban renewal or concentrated code enforcement areas. He appears, then, to be talking about preventive rehabilitation, or the nipping of decay in the bud before it has advanced too far. This is certainly desirable. But it hardly relates to all the inner city's run down housing. Neither is it a recommendation that rehabilitation standards be dramatically lowered, as some have interpreted it. Indeed, he says that his minimal rehabilitation would have to be accompanied by maximum rehabilitation and even new construction. In my own opinion, HUD's PG-50—minimum property standards for rehabilitation—developed in 1963 and republished in 1965, remains as realistic and flexible a guide for establishing standards in rehabilitation areas as anything we have.

Physical standards have been the subject of a hot debate. The reason is that most of these debates have been carried on in the abstract. The only way to determine what must be done to rehabilitate a house is to inspect it carefully. Even then there will remain some uncertainty because some things can be decided upon only after the walls are taken down or a hole is put in them. It has been the experience of the writer that reasonable people usually agree if they walk through a house together. The following partial checklist is intended to illustrate how decisions must be made on standards for rehabilitation:

(1) *Structural soundness*

Is the basic structure of a house or apartment basically sound? Are the foundations weak? Is a wall sagging badly? If so, the rehabilitation cost will probably be excessive.

(2) *Exterior*

What is the condition of the exterior? If it is wood, can it be patched and painted, or must it be replaced? If it is brick, can it be painted or does it need replacement?

(3) *Windows and sills*

Are the windows usable? Do they need repair or replacement? This and other decisions are made not on the grounds of making the build-

¹³ William G. Grigsby and Louis Rosenberg, *Urban Housing Policy*, A.P.S. Publications, New York, 1971.

ing over into a new structure, but on the more elementary grounds of what is required to make the structure livable and weathertight. The cost difference between deciding that window sills can be repaired rather than replaced can have an enormous effect on cost. Wherever possible the decision should be made to repair.

(4) *Interior walls*

What is the condition of the plaster or wallboard? Can it be patched and painted? Or does it need to be replaced completely? Again, there is an enormous difference in cost.

(5) *Kitchens and baths*

Are the facilities in the kitchen and bath adequate? Are they usable with some repair? Or must they be replaced? Is there adequate, minimum, storage space in the kitchen and bath? If so, can it be repaired?

(6) *Floors*

What is the condition of the floors? Can they be patched and re-finished? Can they be covered with some economical surface? Or must they be replaced?

(7) *Wiring*

Is the electrical wiring system usable with some small repairs? Are there an adequate number of fixtures? Or is the system hazardous and in need of complete replacement?

(8) *Heating*

Are the radiators usable? Is the piping workable? Is the furnace working? Can it be made so by repairs or does it need replacement?

(9) *Partitions*

Is the room size and arrangement adequate, or must some partitions be moved to provide the spaces essential? In some cases it will be found that movement of partitions will be needed simply to provide the size of living unit required by the market.

This is by no means an exhaustive list. But will give an idea of the very specific questions that must be asked and answered by experienced people. The answers to these questions will usually establish whether rehabilitation is feasible, given the incomes of the people and the subsidies available. When the discussion of rehabilitation standards is brought down to the very specific level, as it must be, differences of opinion usually vanish. The HUD PG-50, mentioned above, is a guide for carrying out this process. Perhaps a better one could be devised today.

11. *Neighborhood participation.*—Effective rehabilitation demands and requires full participation by the neighborhood residents. The residents must not only accept the rehabilitation program, but also they must support it in many ways. Not the least of these is that homeowners must be willing to go into debt to improve their houses. This point, I believe, needs no further elaboration.

12. *Economic and social feasibility.*—To be successful, neighborhood rehabilitation must be economically feasible. That is, the cost of the rehabilitated home must be within the economic means of the residents. There are a number of variables here. The amount and cost of rehabilitation needed is a function of the original condition of the units, the

costs of labor and materials. The ability of the family to afford the cost is related to its income, as well as the kind of financing and subsidy available. Rehabilitation must also be socially feasible; that is to say, that the neighborhood population should have sufficient morale and motivation to undertake the rehabilitation, pay for it, and maintain the house in its improved condition when the work is completed. The establishment of feasibility is a vital planning step. Professor Chester Rapkin, of Princeton University, has done some feasibility studies that are models of their kind. A locality is risking much to enter a neighborhood rehabilitation effort before and until feasibility has been established. This kind of study is the best guide for choosing neighborhoods for rehabilitation and rejecting others. It will greatly increase the probabilities of success. A detailed study of the results of rehabilitation experience over the past 10 years—its successes and failures and the reasons behind them—could produce a greatly improved basis for establishing the feasibility of rehabilitation.

13. *Family displacement.*—Rehabilitation is often touted as a way to avoid family displacement, such as that which has caused so much discontent with slum clearance. This is not always so. Where the neighborhood is predominantly owner-occupied, rehabilitation can usually be accomplished without displacement, if the work to be done is not major. But, where the dwellings are owned by absentee landlords and must be purchased and rehabilitated, as was the typical case in Project Rehab, family displacement is difficult, if not impossible, to avoid. This requires the same careful and sympathetic relocation service required for slum clearance. A few efforts have been made to avoid permanent displacement by various techniques. Some have been reasonably successful. But the added time required to carry out rehabilitation so as to avoid permanent displacement can greatly increase costs, as it did in FHA's experiment in 114th Street in New York.

14. *Racial implications.*—Where racial segregation exists, as it too often does in inner-city areas, rehabilitation involves an implicit acceptance of this reality. Racial dispersion is a more appealing option, and this goal has been pursued in various ways without striking success. While we have made considerable progress in eliminating racial discrimination, the residential segregation of the races has been intensified, according to the latest Census figures. The implications of inner-city rehabilitation might be expressed thus: If we cannot expect to achieve true racial integration within the short-term future, then there is a good case to be made for improving the living conditions of minorities where they now live.

THE ULTIMATE QUESTION

Earlier in this report, we identified the conditions which characterize many slum neighborhoods. They are physical deterioration of buildings and neighborhoods, as well as a decline in public services. They are also crime and vandalism, poverty, abandonment, and high unemployment, particularly of young people. By far the most significant characteristic, however, is social decay—families who are hopeless, lack motivation, self-discipline, the will and the skill to adapt. Whether we call it the culture of poverty, as Banfield does; family breakdown, as Moynihan does; or lack of upward mobility, as the

public housing people do; this condition is at the root of the slum problem. Among this sad welter of social pathologies, the quality of housing is not the cause, it is more likely the symptom. The public housing experience is, in many places, a vivid example of this fact.

James Pickman, of the Bedford-Stuyvesant Restoration Corporation has said: "We believe that the provision of highly visible, attractive and economically sound projects will alter the quality of life—change the perceptions of business people and area residents with regard to their prospects for the future—and thereby halt and reverse the flow of enterprises, services and dollars from the area. Physical restoration (will) instill a spirit of growth and confidence in the future (of the community)."¹⁴ We have all believed this and based our efforts on this expectation.

But, by now, we have seen too many cases where improved housing was not enough to counteract the far more potent negative social forces at work. More than 16 years ago Millspaugh and Breckenfeld recognized this in their careful study of rehabilitation efforts in Baltimore.¹⁵ It has long been known that improved housing alone is not enough. Many efforts have been made to reach the deeper causes of neighborhood decay. These include improved management, various social services, homeownership, welfare, education, security measures against crime, and many others. The model cities program was a dramatic thrust in this direction. But there is now general agreement among thoughtful observers that we simply do not know how to deal effectively with these deep-lying causes of the slum condition. Elliot Richardson, who has reason to know from his experience as Secretary of HEW and Attorney General, has said that we do not understand the reasons behind the rising rate of crime.¹⁶ Charles Haar, one of the architects of the Model Cities program, is similarly humble about our understanding of the causes of the social pathologies of slum neighborhoods.¹⁷ The Urban Institute says "that in 1976 there is less consensus on ultimate causes of many serious urban problems, and even less consensus on the measures that would eliminate them than there was in 1966."¹⁸

This leads to several inevitable conclusions. We know that improving housing is not enough to reverse the downward spiral in neighborhoods afflicted by deep social pathologies. We do not know exactly how to deal with these more fundamental causes of the slum condition. It follows that money and energy spent on housing improvement in neighborhoods significantly affected by these pathologies are likely to be wasted and to produce no permanent neighborhood improvement. The results of rehabilitation efforts in Boston and New York, discussed earlier, seem to confirm this reality.

At the same time the results in Detroit, New York, and even in Boston (reported earlier) show that a high proportion of slum dwellers

¹⁴ Statement by James Pickman, Vice President, Bedford-Stuyvesant Restoration Corp., before House Committee on Banking, Currency and Housing, Sept. 22, 1976.

¹⁵ Martin Millspaugh and Gureny Breckenfeld, *The Human Side of Urban Renewal, Flight Blight, Inc.*, Baltimore, 1958.

¹⁶ Elliot Richardson, *The Creative Balance*, Holt, Rinehart, and Winston, New York, 1975.

¹⁷ Charles H. Haar, *Between the Idea and the Reality*, Little, Brown and Co., Boston, 1975.

¹⁸ Gorham and Glazer, op. cit.

did maintain their improved homes. But it takes only a small fraction of destructive families to destroy a project. This presents a more hopeful prospect than many current pessimists seem to think justified.

I have discussed this matter recently with former HUD Secretary Robert C. Weaver, now Distinguished Professor of Urban Affairs at Hunter College. He thinks that jobs may be the most important constructive remedy for the slum condition, while recognizing that there is still much that we do not know. His views point to the importance of the general economic policy as a prime factor in exacerbating the slum condition. Too little attention has been paid, I think, to the effects of unemployment and inflation on slum residents. We know that unemployment is higher in poverty areas, and highest among youth. We also know that inflation erodes more quickly the small incomes of slum dwellers.

Where does all this leave us? It suggests three directions for public policy: (1) In rehabilitation, we should select neighborhoods where the deadly social pathologies are missing or not so strong as to negate the effects of improving the physical condition of houses and neighborhoods, where there is a good chance that residents will respond to improved housing and make an effort to maintain it. This means careful neighborhood selection and perhaps tenant selection as well. It means preventative rehabilitation to arrest the decay cycle where it has just begun or is not far advanced. In some slum neighborhoods decay is so far advanced that they will not respond to rehabilitation carried out within the limits of our present knowledge; (2) it means continued social experimentation to gain improved understanding of the complex social forces at the root of neighborhood decay so that we can design more effective tools for dealing with them; (3) it means paying more attention to the effects of general economic policy on slum conditions. HUD should attempt to persuade the economic policymakers of the close relationship between slum conditions and general economic policy and the great social, as well as economic, cost of high inner-city unemployment. The Secretary of HUD does not make general economic policy, but he, or she, cannot ignore and should make known the effects of economic policy on housing and slum conditions.

TOWARD A REHABILITATION STRATEGY

We should proceed at full speed to mount local programs of residential rehabilitation which can save from further decay those neighborhoods that can be saved, in the light of our present knowledge. These efforts should be based on the lessons of the past 15 years described in this paper. They are not broadly understood and HUD should promulgate them widely. At the same time we should study the history more thoroughly to extend and sharpen the lessons they hold. There are a great many neighborhoods and dwellings that fit this limited prescription for rehabilitation. Grigsby found that one-half of the inner city housing stock in Baltimore was only moderately decayed and 90 percent of the substandard units in the city as a whole fell into this category.¹⁹ While a limited degree of property decay in a neighbor-

¹⁹ William Grigsby, *op. cit.*

hood is no sure indicator that the deeper social pathologies do not exist, it suggests that this may be the case. At least, it is a starting point for the process of neighborhood selection which is so crucial to proper rehabilitation planning.

The rehabilitation program itself can be established in a number of ways. It can be directed by the city. It can be spearheaded by the State department of community affairs or the State housing finance agency. It can be carried out by neighborhood organizations, or by private lenders and private rehabilitation contractors. Whichever group takes the leadership it must gain the cooperation of the city, the neighborhood, the contractors, and the financial community.

Whichever group takes the lead, the rehabilitation program should contain these essential ingredients: (1) It should be concentrated but should cover a complete neighborhood; (2) it should provide improvement of neighborhood facilities and services as well as housing rehabilitation; (3) it should recognize the important difference between owner-occupied structures and absentee-owned structures and should include appropriate strategies to deal with both; (4) it should employ a sufficient number of people skilled in the neighborhood organization, work writeups, financing, homeowner counseling, and related matters; (5) it should be supported by adequate flexible financing and subsidies to bring the cost of rehabilitation within the means of neighborhood residents. Subsidies may be provided under section 8, section 235 and 236, section 312, or through use of block grant funds. FHA insured loans for property improvement under title I of the National Housing Act are not recommended. These loans are limited to 12 years or less and carry interest rates of 11 percent or more. They will be beyond the means of all but those of relatively high income; (6) it should establish realistic standards for physical improvements backed by local code enforcement; (7) it should involve extensive neighborhood participation in the planning and execution of the effort, not a small job; (8) the rehabilitation program should be established in advance by inspections and studies to be economically and socially feasible; and (9) adequate provision should be made for handling such family displacement as may become necessary. All these, and other elements of rehabilitation strategy are discussed above in some detail. The most important element, of course, is the leadership provided, its skill, its understanding of the process, its capacity to deal with the various groups who must be involved, and its patience, dedication and commitment to the job.

Looking toward the future, HUD should initiate a series of carefully designed rehabilitation experiments aimed at finding out answers to how to deal effectively with the small percentage of problem families which can wreck an entire rehabilitation effort. As a matter of public policy, the Federal Government cannot ignore these families. The answer is clearly not to improve housing alone. But the search for that answer cannot be abandoned.

WHAT VOLUME CAN WE EXPECT?

A witness at a recent hearing of the House Committee on Banking, Currency, and Housing estimated that less than 25,000 housing

units were being rehabilitated each year. He expressed the view that much more could be done if funds were available.²⁰ HUD reports show that funds for about 33,000 units of rehabilitation have been allocated, or earmarked, under the section 8 program, the section 312 direct loan program, and through the block grant program. This is an optimistic figure, for experience strongly suggests that allocations do not always turn into actual rehabilitation. For example, we have used HUD's figure of 10,000 units under section 8, when only 500 are reported to be completed. Therefore, HUD's published figures on rehabilitation are not inconsistent with the estimates made before the House committee mentioned above. If anything, HUD's figures suggest that the 25,000-unit-a-year estimate may be a bit high. This contrasts strikingly with the hoped-for 2 million units of rehabilitation over a 10-year period in the original 1968 national housing goals. It is the difference between under 25,000 units a year and 200,000 units a year. Whether the volume of rehabilitation can be increased during the coming 2 years depends upon two things:

The first is the availability of funds to finance and subsidize the effort, through block grants, section 312 or section 8 or some other program. Given the known interest and capacity of a number of localities, the volume of rehabilitation could undoubtedly be increased, perhaps doubled to 50,000 units annually, through an increase in funds, particularly if the funds provided were available only for residential rehabilitation. Beyond that, any increase in rehabilitation volume will depend on the development of local capacity, skilled people, more contractors, et cetera. This cannot be accomplished overnight. This desirable development could be speeded up, however, by an increase in available funds—especially if the commitment were long-term. But, even if funds are provided, an annual increase in rehabilitation volume above about 50,000 units is most unlikely within the next 2 fiscal years. We should not overlook, also, that an increase in rehabilitation volume alone means little, as the experiences reported here demonstrate. What counts is whether the rehabilitation results in permanent improvement in housing and neighborhood conditions. The experiences reported here show that success for rehabilitation is not impossible, but it is difficult. We need to build on what we have learned, and what more can be learned from past experience, through experimentation, and thus expand the neighborhoods and the people for which rehabilitation can be successfully achieved. The need for neighborhood rehabilitation is great. The cities are committed to it. The longrun prospects for its expansion are promising. This is not the time to give up on this vital job of revitalizing America's slums and decaying neighborhoods.

²⁰ Testimony of Robert T. Bonham, President, Urban Home Ownership Corp., before the House Committee on Banking, Currency and Housing, Sept. 22, 1976.

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