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Changes to Section 8 Housing Voucher Renewal Funding, FY2003-FY2006

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Summary

Changes enacted by Congress during the appropriations process in each of the past several years have significantly altered the way that public housing authorities (PHAs) receive funding to administer the Section 8 Housing Choice Voucher program. Designed to curb growing federal expenditures, these new formulas have resulted in budgets that have not kept up with cost growth for some local agencies and possibly surplus funds for others. The Administration has proposed to reform the program, including the funding formula, each year since FY2003. No legislation has been enacted, but bills were introduced in the 108th Congress and have been introduced in the 109th Congress (H.R. 1999 and S. 771). This report describes changes in the formula that were included in appropriations bills for FY2003 through FY2006; it will not be updated. For more information on the Section 8 voucher program, see CRS Report RL32284, *An Overview of the Section 8 Housing Programs*, and CRS Report RL33270, *The Section 8 Housing Voucher Program: Reform Proposals*, both by Maggie McCarty.

Each year, Congress provides funding to the Department of Housing and Urban Development (HUD) to renew the more than 2.1 million Section 8 vouchers — also called Housing Choice Vouchers — authorized by Congress (see **Table 1** below). The Section 8 voucher program is federally funded and governed by federal rules, but is administered at the local level by quasi-governmental PHAs. Section 8 vouchers are rental subsidies that low-income families use in the private market to help make up the difference between their rent and their expected contribution toward that rent (30% of adjusted income). The cost of a voucher to a PHA is the difference between the lesser of a tenant's actual rent or the maximum subsidy level set by the PHA — called a payment standard — and 30% of a tenant's income. That cost increases or decreases with changes in tenant incomes and changes in rents and payment standards. In recent years, Congress has enacted, and HUD has implemented, a series of changes in the way that voucher renewal funding is distributed to local PHAs. These changes have led to funding uncertainty for many PHAs, and has put pressure on Congress to adopt a permanent funding formula, possibly through enactment of Section 8 voucher reform legislation.

Table 1. Section 8 Voucher Renewal Funding, FY2003-FY2006

(in millions of dollars)

	FY2003	FY2004	FY2005	FY2006
Renewal Funding	11,259	12,721	13,355	13,949

Source: Figures are derived from HUD budget documents. For more details, see CRS Appropriations Reports. The FY2006 figure is taken from HUD's website [<http://www.hud.gov/offices/pih/programs/hcv/1>]. Central Reserve funding is included.

Pre-FY2003 Funding. Prior to FY2003, PHAs administering the voucher program were funded based on their average annual per-voucher cost from the previous year, adjusted by an inflation factor and multiplied by the number of vouchers that the PHA was authorized to lease.¹ In the event that a PHA's voucher costs increased faster than the inflation factor established by HUD, HUD maintained a reserve equal to one month of voucher funding on behalf of each PHA. However, few PHAs were able to lease 100% of their authorized vouchers, so they typically had more money in their budgets than they needed, and they rarely had to dip into their one-month program reserves, even if their costs rose significantly. At the end of the year, HUD and each PHA would reconcile their budgets, and HUD was typically able to recapture unused funds from PHAs' budgets.

HUD generally used this same formula — last year's actual costs, plus inflation, times the number of authorized vouchers — each year to determine how much funding to request from Congress for the renewal of tenant-based Section 8 vouchers. HUD would also make available to Congress for rescission those unused funds that the agency had recaptured from PHAs. The end result of this system *for PHAs* was that their funding increased along with their costs. If their costs dropped, they were permitted to use some of their excess funds to create new vouchers, a process called maximized leasing. The end result of this system *for Congress* was that each year it provided more funds for voucher renewals than PHAs could reasonably be expected to use, and then recaptured those unused funds the following year to offset the cost of that year's appropriation.

FY2003 Funding Changes. In FY2003, Congress changed the way PHAs were funded in an attempt to limit recaptures of unspent funds and provide funding levels that better reflected actual use. HUD was directed to fund PHAs based on their average annual per-voucher cost from the previous year, increased by the inflation factor, and multiplied by the number of vouchers the PHA could *reasonably be expected to lease in that year* (rather than the larger number of *authorized* vouchers). Specifically, the law stated,

The Secretary shall renew expiring section 8 tenant-based annual contributions contracts for each public housing agency ... based on the total number of unit months which were under lease as reported on the most recent end-of-year financial statement submitted by the public housing agency to the Department, adjusted by such additional information submitted by the public housing agency ... regarding the total number of unit months under lease at the time of renewal of the annual contributions contract, and

¹ PHAs "lease" vouchers when they sign contracts with tenants and landlords under which PHAs agree to provide payments to landlords on behalf of tenants. Each PHA has a fixed number of vouchers it is authorized to "lease."

by applying an inflation factor based on local or regional factors to the actual per-unit cost as reported on such statement. (P.L. 108-7, Title II, Section (1))

HUD implemented this provision so that PHAs' budgets were based on their utilization rates and costs as reported on their end-of-the-year statements, *or more recent data*, if available. As stated in guidance released by HUD:

Renewal calculations under the [Federal Fiscal Year] 2003 Appropriation will be based on the total number of unit months under lease and actual cost data, as reported on the PHA's most recent year-end settlement or as subsequently submitted to HUD by the PHA. Actual costs will be adjusted by applying the [Annual Adjustment Factors]. Expiring voucher funding increments will generally be renewed for terms of three months. The use of the most recent leasing and cost data and the short renewal terms will enable HUD to calculate funding more accurately than previous procedures allowed. (HUD Notice PIH 2003-23, Issued Sept. 22, 2003)

Congress also created a Central Reserve fund to be used by the Secretary to replenish PHA one-month reserves in the event that PHAs had to use their reserves to cover the costs of increased utilization or increased per-voucher costs. The language of the law stated in regard to the Central Reserve fund:

The Secretary may use amounts made available in such fund, as necessary, for contract amendments resulting from a significant increase in the per-unit cost of vouchers or an increase in the total number of unit months under lease as compared to the per-unit cost or the total number of unit months provided for by the annual contributions contract. (P.L. 108-7, Title II, Section (2))

Finally, the bill instituted restrictions on maximized leasing, stating that none of the funds provided in the act could be used to support more vouchers than a PHA was authorized to lease in a year.

FY2004 Funding Changes. The FY2004 appropriations law continued in the direction of the FY2003 funding bill, instructing HUD to fund PHAs based on actual utilization of vouchers — rather than on the total number of vouchers they were authorized to lease — and restricting the use of funds for maximized leasing. Moreover, the conference report that accompanied the FY2004 appropriations law stated that the conferees were concerned about “spiraling” cost increases in the voucher program and that they expected the Secretary to control costs. As stated in the conference report:

The conferees are aware that the Secretary has the administrative authority to control the rapidly rising costs of renewing expiring annual contributions contracts (ACC), including the budget-based² practice of renewing expiring ACCs, and expect the Secretary to utilize these tools. (H.Rept. 108-235, Title II)

The FY2004 appropriations language was changed from FY2003 to state:

The Secretary shall renew expiring section 8 tenant based annual contributions contracts for each public housing agency ... based on the total number of unit months

² Budget-basing provides PHAs with a budget based on a fixed dollar amount, rather than a fixed number of vouchers.

which were under lease as reported on the most recent end-of-year financial statement submitted by the public housing agency to the Department, or as adjusted by such additional information submitted by the public housing agency to the Secretary as of August 1, 2003 (subject to verification), and by applying an inflation factor based on local or regional factors to the actual per-unit cost. (P.L. 108-199, Title II, Section (1))

The FY2004 language also varied from the FY2003 language in terms of how the Central Reserve fund could be used. In FY2003, the Central Reserve fund could be used to replenish PHA reserves that had been depleted due to either increased utilization rates or increased costs. In FY2004, the language allowed the Secretary to only use Central Reserve funds to replenish reserves depleted because of increased utilization, *not* increased costs:

Language proposed by the House and Senate is not included to allow the Central Fund to also be used for increased per-unit costs as such costs have been reflected in the amount provided for renewals. (H.Rept. 108-401, Division G, Title II)

HUD issued a notice on April 22, 2004 (PIH 2004-7) implementing the FY2004 appropriations law. According to the notice, PHAs' budgets would be based on their utilization rates from their end-of-the-year statements, or more recent data if available, and costs as reported on their end-of-the-year statements as of August 1, 2003, adjusted by the annual adjustment factor (AAF), *but not adjusted by more recent data, even if available*. The notice stated that PHAs could appeal to the Secretary only if they could document that *rental* costs in their areas had risen higher than the inflation factor adopted by HUD. The notice proved controversial. Some housing advocates contended that Congress gave HUD the authority to use a broader measure of inflation than the AAF, taking into account not just rental costs but also other changes in PHAs' costs, such as utility costs and changes in their caseloads. The notice was not modified, and on August 31, 2004, HUD granted the appeals requests of 380 agencies out of approximately 400 that applied, distributing a total of \$160 million from the Central Reserve. However, HUD did not necessarily provide the full level requested in each appeal.

FY2005 Funding Changes. The final FY2005 Consolidated Appropriations Act (P.L. 108-447) moved the program further in the direction of budget-based funding. It directed the Secretary to fund PHAs based on their voucher costs and utilization rates as of May-July 2004 plus the HUD-published AAF, adjusted for new tenant protection vouchers.³ If a PHA's May-July data were not available, HUD was directed to fund the agency based on February-April 2004 data, or if these data were not available, to fund the PHA based on its most recently submitted year-end financial statement, as of March 31, 2004. If the amount provided in the law was insufficient to fund all PHA budgets under this formula, then the Secretary was directed to prorate agency budgets. According to the conference report (H.Rept. 108-792), PHAs were expected to manage their voucher programs within their budgets for FY2005, regardless of their actual costs. The report also stated that "HUD shall provide agencies with flexibility to adjust payment standards and portability policies as necessary to manage within their 2005 budgets." Agency reserves were reduced from the one-month to the one-week level and no Central Reserve was

³ Tenant protection vouchers are given to families being displaced from other HUD assistance programs (such as public housing). PHAs' costs may increase from one year to the next because of an increase in the number of tenant protection vouchers they are administering.

provided to replenish depleted reserves. Finally, the act continued the prohibition on maximized leasing.

HUD published guidance implementing these provisions on December 8, 2004 (HUD Notice PIH 2005-1). Agencies received notification of their preliminary budget levels on December 17, 2004. At that time, PHAs were directed to inform HUD of any data errors within 10 days (although the deadline was later extended). The appeals were limited to data errors; agencies were told that they could not appeal the actual formula used for calculating their budgets. The final calculations, including a final proration factor, were published on January 21, 2005. Agencies were funded generally at 4.03% less than their May-July 2004 actual cost and utilization levels, plus the 2005 AAF. This proration factor of just less than 96% was implemented because the amount of funding provided by Congress for voucher renewals was not sufficient to fund agencies at 100% of the formula amount.

According to CRS analysis of HUD funding data, the median change in PHA renewal budgets from FY2004 to FY2005 was an increase of .17%. This number hides a wide variance; the fifth percentile change was a decrease of 12% and the 95th percentile change was an increase of 14%.

On February 25, 2005, HUD published Notice PIH 2005-9, entitled “[PHA] Flexibility to Manage the Housing Choice Voucher Program in 2005.” It identified administrative options available to PHAs to lower their costs in 2005. Suggestions included lowering payment standards; reducing utility assistance to families; restricting portability;⁴ reviewing rents to ensure they are reasonable in the market; suspending the reissuance of vouchers when families leave the program; restricting bedroom sizes; instituting minimum rents; monitoring income eligibility more strictly; and, most drastically, terminating assistance to families due to insufficient funds.

FY2006 Funding Formula. The FY2006 HUD Appropriations Act (P.L. 109-115) distributes renewal funding using roughly the same formula as FY2005. HUD is to allocate renewal funds to PHAs based on the amount they were eligible to receive in FY2005 (prior to proration), plus inflation (using the AAF), adjusted for additional tenant protection vouchers or vouchers that were reserved for project-based use,⁵ and prorated to fit within the amount appropriated. The act provides the Secretary with \$45 million to adjust the budgets of agencies in two categories: (1) those for whom the May-July period used as the basis for FY2005 funding represented unusually low leasing or costs and who apply to the Secretary for an adjustment; and (2) those whose costs have risen due to unforeseen circumstances or portability billings. The prohibition on maximized leasing was retained in FY2006. HUD issued projected funding letters to all PHAs on January 19, 2006; PHAs were directed to respond with concerns by February 3, 2006.

⁴ Vouchers are nationally portable, meaning that if a family moves from the jurisdiction of one PHA to another, the family retains its assistance. However, if the new jurisdiction does not wish to permanently accept the new voucher (a process called absorption), the new jurisdiction can bill the old jurisdiction. This can present budget problems for the old jurisdiction if rents are significantly higher in the new jurisdiction.

⁵ Vouchers are project-based when they are set aside for use in a particular unit of housing. This adjustment is provided for PHAs who had artificially low utilization rates in May-July 2004 because they had reserved vouchers for new units that were under construction.

Conclusion. Prior to FY2003, the Section 8 voucher program was funded much like an entitlement program; the amount provided by Congress was largely determined by a formula, limiting Congress's ability to constrain funding without facing the prospect of directly terminating assistance to families. The final result of the funding changes, beginning with those enacted for FY2003, has been a conversion of the program's funding structure into one more similar to other discretionary programs in which grantees receive an annual fixed sum of money, regardless of changes in their costs or the number of people served. While these changes have given Congress greater control over the program's budget, many PHAs say the changes have made the program more difficult to administer. PHAs have only limited control over their costs since the value of the subsidies provided to families are statutorily set (as roughly the difference between rent and 30% of income).

In areas where they do have control, such as in setting payment standards, selecting families from the waiting list, and issuing vouchers, PHAs have made some changes. Some have lowered their payment standards from 110% to 100% or less of local fair market rents. Since changes in payment standards only affect future families in the program, some PHAs have undertaken rent reasonableness reviews and reduced rents paid to landlords, some of whom have accepted the cut, others of whom will not renew leases with families. PHAs may be selecting higher-income families from the waiting list (for whom subsidy costs are lower), although the PHAs are still constrained by a requirement that 75% of all vouchers be targeted to the lowest-income families. Many PHAs have intentionally reduced their utilization rates by not reissuing vouchers when families leave the program. Agencies that intentionally lowered their utilization rates in order to save money in FY2004 likely encountered problems in FY2005, as their budgets were capped at their costs *and* utilization rates as of the third quarter of FY2004. It is likely that, at least for some PHAs whose costs have risen faster than their funding under the new formula, these changes resulted in fewer households receiving vouchers in FY2005 than in previous years. That trend should continue into FY2006.

At the same time, some agencies may now be receiving more money than they are legally permitted to spend. Under the formulas used in the past two years, PHAs' funding does not necessarily decrease if their costs decrease (for example, due to changes in the types of families they are serving). Since maximized leasing is prohibited, PHAs may have funds that they are unable to spend recaptured by HUD, even if there are waiting lists for vouchers in their communities.

While the formula has remained consistent between FY2005 and FY2006, the controversy surrounding it has continued. Most low-income housing advocates have called for a return to an actual-cost and unit-based formula, as was used prior to and during FY2003. PHA advocacy groups have been vocal about the difficult predicament that the current formula puts them in, given the statutory constraints under which they must run their programs. The most recent voucher reform bills (H.R. 1999 and S. 771) would require HUD to work with PHAs to develop a new funding allocation formula, possibly based on independent factors such as population, poverty, and housing costs. In the interim, the bills would use a formula similar to the FY2005 and FY2006 formula. Modification to the current formula will result in both winners and losers, unless funding for the program is increased significantly or hold-harmless provisions are enacted. Therefore, the process to develop a new formula, particularly in an environment of domestic discretionary budget constraints, will likely be difficult and controversial.