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Just Suppose:
Housing Subsidies for Low-Income Renters

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Abstract

This paper considers what the appropriate design of government policies towards rental housing subsidies would be in the absence of the long and mixed legacy of public intervention in housing markets. The fundamental housing problem facing low-income households is the high cost of rental housing and the high rent burdens these households face. This is best addressed by an entitlement program for shelter subsidies modeled after the food stamp program or the Earned Income Tax Credit Program. A universal program would remove glaring inequities in the current treatment of identically situated low-income households, and it would eliminate most of the inefficiencies in the current mixed program of supply and demand subsidies for rental households.

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I. Introduction

In most aspects of government policy, "history matters." This is probably more extreme: in programs involving lumpy and costly investments with long useful lives, and where political consensus is more difficult to achieve. The importance of history – or the path dependency of policy – is nowhere more apparent than in federal housing policy. John Weicher observed in 1980 that housing "programs can only be understood from a historical perspective." (Weicher, 1980, p.3) A quarter century later, after having served in managerial and policy positions in three national administrations, Weicher had been even more convinced of the importance of historical accident in understanding current policies (Weicher, 2006).

In this essay, I deliberately ignore this path dependence. Instead, I ask: what housing policies would we create if we were starting from scratch? I concentrate on subsidies for rental housing. Rental housing represents a small fraction (about a third) of federal government support for housing, and the configuration of current policy is less dependent upon the political choices reflected in the original income tax statutes passed by the Congress in 1913. Of course, even in rental housing, one cannot completely ignore history in thinking about or advocating good policy. So Section II starts with a very brief history – a thumbnail sketch – of federal subsidy policy towards rental housing. In Section III we consider the economic rationale for national policies about rental housing; we also consider other motives in which economic considerations are subsidiary. In Section IV we outline a rental housing policy more or less consistent with these rationales. We also speculate a bit on its practicalities.

II. A Brief History

A. Programs

Direct federal expenditures on housing began with the Public Housing Act of 1937. The Act which was intended to "remedy the acute shortage" of decent housing through a federally financed construction program which sought the "elimination of substandard and other inadequate housing." Infrastructure investment in big cities was good fiscal policy in an economy with 17 percent of its workers unemployed, and the program provided shelter for some of those "temporarily" unemployed in the great depression. By some accounts, public housing was thought to be transitional housing to be occupied by households for short periods of time until they could enter the economic mainstream.

For a quarter century, low rent public housing was the only federal program providing housing assistance for the poor. Dwellings built under the public housing program are financed by the federal government, but are owned and managed by local housing authorities. Importantly, the rental terms for public housing specified by the federal government (in return for financing) ensure occupancy by low-income households, currently at rents no greater than thirty percent of household incomes.

This program of government construction of dwellings reserved for occupancy by low-income households was supplemented by a variety of programs inviting the participation of limited-dividend and nonprofit corporations in the 1960s. These latter programs directly increased the supply of "affordable" housing, but not the stock of government-owned housing. A program of below-market-interest-rate loans made to nonprofit and cooperative builders (1968), rent supplements on behalf of selected households (1969), and rental assistance (Section 236 of the National Housing Act of 1970) provided funds to developers to amortize investments in new housing while charging low-income tenants no more than a fifth or a quarter of their incomes in rent. These capital subsidy programs, designed for a low-interest-rate environment, proved unworkable as interest rates increased. These programs were suspended in the early 1970s. But housing capital is long-lived, and near the turn of this century there were still more than half a million units subsidized by these programs in the housing stock (U. S. Department of Housing and Urban Development, HUD, 1998).

Section 8 of the Housing and Community Development Act of 1974 increased participation by private for-profit entities in the provision of housing for the poor. The Act provided for federal funds for the "new construction or substantial rehabilitation" of dwellings for occupancy by low-income households. The federal government entered into long-term contracts with private housing developers, guaranteeing a stream of payments of "fair market rents," FMRs, for the dwellings. Low-income households pay twenty-five (now thirty) percent of their incomes on rent and the difference between tenant payments and the contractual FMR is made up by direct federal payments to the owners of the properties.

Crucial modifications to housing assistance policy were introduced in the Section 8 housing program: the restriction that subsidies are paid only to owners of new or rehabilitated dwellings was weakened and ultimately removed; and payments were permitted to landlords on behalf of a specific tenant (rather than by a long-term contract with the landlord). This tenant-based assistance program grew into the more flexible voucher program introduced in 1987. Households in possession of vouchers receive the difference between the "fair market rent" in a locality and thirty percent of their incomes. Households in possession of a voucher may choose to pay more than the fair market rent (estimated regularly for each metropolitan area by the U.S. Department of Housing and Urban Development, HUD) for any particular dwelling, up to forty percent of their incomes, making up the difference themselves. They may also pocket the difference if they can rent a HUD-approved dwelling for less than the FMR.

In 1998, legislation made vouchers and certificates "portable," thereby increasing household choice and facilitating movement among regions in response to employment opportunities. Local authorities were also permitted to vary their payment standards between 90 and 110 percent of FMR. The 1998 legislation renamed the program the "Housing Choice Voucher Program."

In thinking about current housing policy choices, it is important to recognize that until thirty years ago, housing assistance to low-income renters was inextricably tied to investment in constructing new dwellings. The voucher and certificate programs drastically reduced the role of the Department of Housing and Urban Development in building housing for occupancy by low-income renters. And it reduced direct federal expenditures in building new dwellings for low-income households. But other forces increased the indirect subsidies provided to the construction of new housing to be occupied at low rents.

The Tax Reform Act of 1986 limited the power of state governments to issue tax-exempt debt to finance infrastructure investments for "private purposes." Accordingly, state bonds issued for multifamily housing construction were limited in the legislation. However, the Act also established a Low-Income Housing Tax Credit (LIHTC) Program to provide direct subsidies for the construction or acquisition of new or substantially rehabilitated rental housing for occupancy by lower income households. The LIHTC Program permits states to issue federal tax credits that can be used by property owners to offset taxes on other income, or which can be sold to outside investors to raise initial development funds for a project. To qualify, a project must have a specific proportion of its dwelling units set aside for lower-income households, and rents for these dwellings are limited to thirty percent of income. Qualifying owners may elect to set aside twenty percent of units for households with incomes below fifty percent of the median income in the local area, or they may set aside forty percent of units for households with incomes below sixty percent of area median. Qualification requires that these units be earmarked for occupancy by lower-income households for a period of thirty years.

The aggregate amount of tax credits authorized by the LIHTC program has been increased several times since its inception, to $1.75 per person in 2002, with automatic adjustments for inflation annually since 2003. Federal tax credit authority is transmitted to each state, on a per capita basis, for subsequent distribution to developers of qualified projects.

The amount of tax credit that can be allocated to a specific project is a function of its (non-land) development costs, the proportion of units set aside for lower-income households, and its credit rate (four percent for projects which are also financed by tax-exempt state bonds and nine percent for other projects.) The credits are provided annually for ten years, so a "dollar" of tax credit authority issued today has a present value of six to eight dollars.

The HOME Investment Partnerships, authorized by the National Affordable Housing Act of 1990, provide some additional funds for supply-side rental programs. HOME funding is a formula block grant to local governments for the construction and renovation of rental housing and for tenant-based assistance (as well as the construction and renovation of owner-occupied housing and assistance to home buyers). The HOME block grant provides great flexibility to local governments in choice of programs, requiring a set-aside of funds for non-profit Community Housing Development Organizations (See O'Regan and Quigley, 2000).

Jurisdictions participating in the HOME partnership have chosen to allocate about half of their grant proceeds to rental housing since funding began in 1992, but allocations to rental housing have been systematically reduced over time (to about forty percent in 2002). Only one percent of grant proceeds are used for tenant-based rental assistance. Annual funding for the HOME program was $1.4 billion in 2004. (See Turnham, et al, 2004.)

B. Expenditures

Direct expenditures, tax expenditures, and guarantee costs are all public subsidies, and thus liabilities of the federal treasury. However, only direct expenditures are observable in the annual budget adopted by the federal government. The budget reports government outlays (i.e., actual expenditures) in any fiscal as well as budget authority (i.e., the aggregate federal commitment of public funds available for expenditures in current and future years).

Table 1 reports the net budget authority and federal outlays for low-income rental assistance administered by HUD during the past three decades. As indicated in the table, since 1976 federal expenditures on low-income rental housing (public housing, project- based assistance, and vouchers) have more than quadrupled in constant dollars – from

Table 1. Net Budget Authority and Government Outlays for Low-Income Rental Assistance: Major HUD Programs[1]

Fiscal Years 1976-2007

(Millions of 2006 Dollars)

Fiscal Year	Net Budget Authority	Federal Outlays
1976	$62,330	$7,902
1977	85,096	8,664
1978	89,988	10,084
1979	63,384	10,974
1980	64,789	12,877
1981	56,411	16,045
1982	28,455	16,891
1983	19,480	18,527
1984	23,363	19,867
1985	45,652	43,269
1986	19,545	20,746
1987	16,181	20,761
1988	15,369	22,053
1989	14,203	22,568
1990	15,873	23,607
1991	27,278	24,115
1992	23,721	25,153
1993	25,027	27,618
1994	23,967	29,345
1995	15,376	32,553
1996	16,839	30,519
1997	10,472	30,808
1998	15,428	29,795
1999	18,145	27,565
2000	14,720	27,980
2001	21,868	28,513
2002	23,099	30,746
2003	24,428	32,237
2004	24,826	32,486
2005	24,547	32,297
2006	24,933	31,945
2007	24,731	31,525

Source: US Office of Management and Budget, *Public Budget Database*, Budget of the United States Government, Fiscal Year 2007.
Note: 1 Includes public housing, project-based assistance, and voucher programs.

$7.9 billion to $31.5 billion. Despite the large increase in expenditures on low-income housing programs, net budget authority issued by Congress has declined substantially, by about forty percent during the period, from $62.3 billion in 1976 to $24.7 billion in 2007. This reflects the gradual shift in low-income housing assistance outlined above, from project-oriented to tenant-oriented subsidies. New long-term commitments under production-oriented approaches were sharply curtailed in the early 1970s, but pre-existing commitments under the Public Housing and Section 8 new construction programs continue to provide shelter for a substantial number of low-income households.

Table 2 shows the evolution of new federal commitments for subsidized rental housing through the late-1990s using dwellings as the units of observation[1]. Two trends are apparent. First, the distribution of subsidy commitments between newly constructed and existing dwellings has changed markedly. In 1977, two thirds of new funding commitments went to new construction. By 1997, almost three-quarters of new federal commitments were made to pre-existing units. Second, the net number of new federal commitments for housing has plummeted – by more than two-thirds between 1981 and 1997.

The legacy of previous program commitments, of course, means that the current mix of subsidized dwellings includes a larger fraction of dwellings newly constructed for occupancy by subsidized low-income households. Table 2 also reports these trends through the late 1990s. During the period covered, subsidized renter households living in pre-existing housing increased more than tenfold, to more than two million, but in 1997

[1] For some reason, data on subsidized units are no longer regularly published by HUD or by the House Ways and Means Committee.

Table 2. New Commitments for Subsidized Rental Housing and Total Number of Rental Households Served, 1977-1997

	New Commitments (Number of Units)		Households Served (thousands of households)	
Fiscal Year	**New Construction**	**Existing Housing**	**New Construction**	**Existing Housing**
1977	247,667	127,581	1825	268
1978	214,503	126,472	1,977	423
1979	231,156	102,669	2,052	602
1980	155,001	58,402	2,189	707
1981	94,914	83,520	2,379	820
1982	48,157	37,818	2,559	844
1983	23,861	54,071	2,702	955
1984	36,719	78,648	2,836	1,086
1985	42,667	85,741	2,931	1,180
1986	37,375	85,476	2,986	1,253
1987	37,247	72,788	3,047	1,366
1988	36,456	65,295	3,085	1,446
1989	30,049	68,858	3,117	1,534
1990	23,491	61,309	3,141	1,616
1991	28,478	55,900	3,180	1,678
1992	38,324	62,595	3,204	1,721
1993	34,065	50,593	3,196	1,900
1994	29,194	66,907	3,213	1,985
1995	19,440	25,822	3,242	2,081
1996	16,259	36,696	3,293	2,021
1997	14,027	36,134	3,305	2,051

Source: US House of Representatives, Committee on Ways and Means, *Green Book, 1998,* table 15-26, table 15-25; US Department of Housing and Urban Development.

more than sixty percent of subsidized renters lived in dwellings that had involved new construction at the time subsidized occupancy began.

For the more recent period, data are available which reflect the growing importance of the voucher and certificate programs utilizing the existing stock of housing. Table 3 reports trends since the turn of the century. During the past seven years, reliance upon vouchers and certificates increased from two-thirds to three-quarters of HUD outlays. In real terms, voucher outlays increased by almost thirty percent, while outlays for public housing and project-based assistance declined by twenty percent. Table 3 also shows a marked decline in the growth of renter subsidies in the recent past. Since 2000, rental housing subsidies have increased by just less than $2.5 billion in real terms, or about one percent per year.

<u>Table 3. Federal Outlays for HUD Supply and Demand Side Programs</u>

Fiscal Years 2000-2007

(Millions of 2006 Dollars)

Fiscal Year	Supply side	Demand side
2000	$9,285	$18,696
2001	9,370	19,143
2002	9,967	20,780
2003	9,278	22,959
2004	8,625	23,860
2005	8,259	24,037
2006	7,908	24,037
2007	7,428	24,097

Source: US Office of Management and Budget, Public Budget Database, *Budget of the United States Government,* Fiscal Year 2007. Note: Supply side programs include public housing and project-based assistance; demand side programs include certificates and vouchers.

Table 4 summarizes comparable information on federal government tax expenditures for rental housing. Tax expenditures for low-income households include tax credits distributed for the construction of low-income housing under the LIHTC and the foregone revenue on tax-exempt multifamily housing bonds. The LIHTC program has grown from $1.2 billion in 1991 to $4.0 billion in 2006 (in 2006 dollars). Multifamily housing bond programs adopted by the states are smaller, declining from about a billion dollars to half that over the same period. In part, this reflects cyclical declines in interest rates which have reduced spreads, making these bonds less attractive to investors.

Table 4. Federal Tax Expenditures for Rental Housing, Fiscal Years 1987-2011 (est.)

(Millions of 2006 Dollars)

Fiscal Year	Homeowner Capital Gains Exclusion	Multi-family Tax Exempt Bonds	Low Income Housing Tax Credit
1987	$7,765	$2,271	$49
1988	10,570	1,966	255
1989	23,371	1,873	437
1990	23,578	1,575	171
1991	22,592	1,460	1,153
1992	24,136	1,487	1,542
1993	24,019	1,343	2,074
1994	28,068	1,276	2,533
1995	24,841	1,188	2,903
1996	24,657	948	3,265
1997	30,474	998	2,834
1998	21,316	183	3,806
1999	21,630	186	3,389
2000	21,718	187	3,760
2001	21,853	183	3,686
2002	22,102	202	3,697
2003	22,194	307	6,803
2004	31,717	384	3,905
2005	37,157	423	4,006
2006 est.	39,750	430	4,060
2007 est.	42,958	440	4,159
2008 est.	47,449	489	4,364
2009 est.	58,614	519	4,609
2010 est.	77,167	528	4,844
2011 est.	85,230	538	5,108

Source: US Office of Management and Budget, *Budget of the United States Government*, Fiscal Years 1982 through 2007.

For comparison, the table also presents the tax expenditures arising from the special treatment of capital gains on owner-occupied housing. This tax expenditure (which reflects the fact that capital gains on owner-occupied housing are accorded a special exclusion provision) is many times larger than the tax expenditures on rental housing reported in the table.[2] Tax

[2] The table does not report the tax expenditures attributable to the exemption accorded to the imputed rental income from owner occupied housing (an additional $26.3 billion in 2004) or the costs of federal guarantees arising from

expenditures associated with capital gains for owner-occupied housing are estimated to be $39.8 billion in 2006, as compared with tax expenditures of $4.5 billion for rental housing. Tax expenditures for capital gains on owner-occupied housing are currently about twenty-five percent larger than federal outlays on all HUD subsidy programs.

III. Why Subsidize Rental Housing?

Why should the national government take an active role in devising policy for rental housing? As noted above, the initial rationale for the provision of public housing was the "acute shortage" of decent housing coupled with the "recurring unemployment" of the time. A combination of idle resources in the economy and a lack of effective demand arising from a calamitous recession launched a program of government-sponsored housing production.

With the post war boom in the American economy, the comprehensive Housing Act of 1949 emphasized the goal of providing "a decent home and a suitable living environment" and "decent, safe and sanitary housing" for all Americans. Improved housing conditions formed the rationale for subsidy policies, and progress could be measured by noting the extent to which inadequate housing was eradicated. In 1975, there were about 2.8 million renter households who lived in "severely inadequate housing," representing almost 11 percent of renter households. By 2001, the last year for which comparable data are available (See Quigley and Raphael, 2004), the number of inadequately housed households by this standard declined by sixty percent. And the fraction of renters living in severely inadequate housing was less than 3.5 percent of the population. Among dwellings "affordable" to the poorest households (earning less than 30 percent of the local Area Median Income, AMI), the fraction of "severely inadequate" housing was about 5.3 percent in 1999, according to the Bipartisan Millennial Housing Commission (2002, p.93). Among dwellings "affordable" to low-income households (earning between 50 and 80 percent of local median income), the fraction classified as severely inadequate was 2.9 percent. Physically inadequate housing is certainly a concern for some households, especially the poorest renters. But for the very poorest households, only five percent of those who pay less than 30 percent of their incomes on rent live in "severely inadequate" housing conditions.

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secondary market activities in support of owner occupied housing ($25.2 billion in 2004). See Jaffee and Quigley, 2006.

Until quite recently, it was widely presumed that the external effects of housing and bad neighborhoods were large, and that neighborhoods with high poverty concentrations where housing was derelict caused social problems. Well-known studies, by Kain (1968) and Wilson (1997) among many others, strongly suggested that unemployment, crime and social disorder were causally related to bad neighborhoods and inadequate housing conditions. This confident consensus has been disrupted by three developments. First, a series of careful studies of specific outcomes has failed to find strong and systematic empirical evidence of a causal nature (e.g., Mayer and Jencks, 1990; Oreopoulis, 2003). While some detailed studies of public housing have documented statistical relationships program participation and individual outcomes, they have not distinguished between household income effects (arising because resources are transferred to the beneficiaries of housing programs) and the influence of housing or neighborhood conditions. (See Newman and Harkness, 2002, for a discussion.) Second, methodological research by statisticians and econometricians suggests that a causal link would be quite hard to establish scientifically, if indeed it existed. (This has been termed the "reflection problem." See Manski, 1995, and Durlauf, 2002.) Third, extensive analysis of a real experiment in exposing households to better neighborhoods has failed to find much evidence of neighborhood effects. These "Moving to Opportunity (MTO)" experiments conducted in five cities during 1994-2002 are reviewed by Goering and Feins (2002); detailed evaluations are available in Kling, Liebman and Katz (2007).[3]

In any case, neither "numbers" nor "quality" provide a very convincing rationale for public subsidies for rental housing in this century, and the results of the MTO experiments underscore the advantages of demand-side housing subsidies which facilitate dispersed residences. Indeed, this all seems well recognized now by politicians, scholars, advocates, and interest groups. For example, the "worst case" housing needs reported by HUD to Congress (HUD, 2000) emphasize high rent burdens as the source of worst case housing need. Since 2000, the Senate has directed HUD to compile and report the extent of worst case housing needs annually. Because the extent of substandard housing is so small, these reports are essentially estimates of the fraction of households in various demographic groups paying in excess of half of

[3] Kling and his colleagues reviewed fifteen primary outcomes for adults and fifteen primary outcomes for youth. They concluded that the experimental treatment had no effect upon the economic self-sufficiency of adults (earnings, welfare participation, and reliance on government assistance), little effect upon the physical health of adults, and quite mixed effects upon youth outcomes. In contrast, the effects upon the mental health of adults were consistently positive.

their incomes on rent (See, for example, HUD, 2005). "Worst case housing need" has evolved into another way of describing poverty.

"Affordability" is clearly the most compelling rationale for polices subsidizing rental housing. The high cost of rental housing, relative to the ability of low-income households to pay for housing, means that these households have few resources left over for expenditures on other goods – food, clothing, medicine – which are also necessities. Because housing represents a large share of household expenditures in market–based economies – for the middle class as well as the poor – small changes in the rent burdens faced by households can have large effects upon their levels of well being. As noted above, improved outcomes in a variety of dimensions almost certainly arise if housing programs provide increased discretionary resources to recipients by reducing rent burdens. The affordability of housing is a legitimate rationale for housing subsidy policies. Indeed, as noted above, it seems to be the only surviving rationale for a large- scale subsidy program for rental housing in the U.S.

This suggests that rental housing programs for low-income households ought to be thought of as a part of the U.S. welfare system – in the same way that we think of income transfers, food stamps, and the earned income tax credit as components of that system.

This perspective highlights the egregious failure of the current system of historically-evolving housing subsidy programs – the horizontal inequity accorded to similarly situated, otherwise identical, households. Under current programs, qualifying households obtain rental housing subsidies through some random process. Households apply for housing assistance through local housing authorities. Despite widespread presumptions to the contrary, virtually all local authorities have long waiting lists – eleven months, on average, in U. S. metropolitan areas (HUD, 1999). Painter (1997) reports that, for the largest public housing authorities, waiting times average almost three years. Indeed, in some housing authorities, waiting lists themselves are often "closed." This means that qualifying households can wait years before obtaining rental assistance. Some may wait years before receiving permission to join the waiting list. Independent housing authorities have their own systems for ranking eligible households. Most authorities adopt some sensible procedure for granting priorities, but selection onto the waiting list and selection from the waiting list has many of the characteristics of winning the sweepstakes.

Compare this to the process of obtaining food stamps or medical assistance under Medicaid. Households are deemed eligible on the basis of income, household size and other demographics (such as disability), and all eligible households qualify for assistance. The only form of welfare assistance that is awarded under the sweepstakes model, rather than the entitlement model, is rental housing. And, as noted above, housing expenses represent a large fraction of the incomes of low-income households. So the inequity is even more glaring. Some fraction of eligibles receive a large subsidy. A larger fraction of eligibles receive nothing. The distribution is capricious.

For example, under current rental subsidy policies, more than seventy percent of households below the poverty line are not served, and more than forty percent of the households who are served are not in poverty (See Curry, 2006, Olson, 2003). This is indefensible.

For 2003, it was reported that 32.8 percent of renters earning less than 30 percent of local median income (roughly $18,500 for a family of four) received housing assistance, and 19.3 percent of renters earning between 31 and 50 percent of local median income (up to about $32,000) received housing assistance. (See HUD, 2005, pp. 50-55. See also Table 5 below.)

Among the lowest income households, the 9.1 million renters with incomes below 30 percent of the local median – more than six million – receive no housing assistance. And of those six million who are unserved, almost five million pay more than half of their incomes on rent.

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

It is obvious that the cost of providing decent quality housing through new construction is much greater than the cost of providing it by utilizing the existing depreciated stock of housing. This fact is well known to builders and developers who almost never target new construction of rental units to the bottom half of the income distribution. (And this fact is also quite well known to slum lords who offer small quantities of housing services to the poor, utilizing on the oldest and most obsolete portion of the housing stock.) These cost differences in shelter provision for low-income households were thoroughly documented in conjunction with the Experimental Housing Allowance Program a quarter century ago. (See, for example, Mayo *et al*, 1980.) More recent analyses by the Government Accountability Office (2001, 2002) suggest that the first-year costs of subsidizing rental households through new construction programs are from 49 to 65 percent more than the costs of subsidizing the same households using vouchers, and the present-value life-cycle costs are from 19 to 38 percent more than are the costs of voucher programs for comparable housing.[4] No conceivable budget which sought to cover all renters below some low-income cutoff could make provisions for the expenditures required to provide newly-constructed housing for assisted households.

IV. A New Rental Housing Policy?

It is not clear that a rental housing subsidy program faithful to the analysis in the previous section could be implemented. In starting from scratch, there are many changes to existing programs to be considered.

First, eligibility rules for rental housing assistance would need to be tightened. Under current law, households with incomes below eighty percent of the area median income, AMI, adjusted for household composition, are eligible for rental housing subsidies. In 2006, this was an average cutoff income of $52,075 for a family of four. In contrast, current eligibility for food stamps for four-person households is confined to those with incomes less than half as large ($25,164). Eligibility under the Earned Income Tax Credit program is limited to households (with one or more children) earning a third less per year ($37,263). Eligibility for rental assistance would have to be tightened considerably to replace a national lottery program with an entitlement program for housing assistance for very low-income renters.

Second, passage of an entitlement program would require considerable support outside the "policy community," and the continuity of the program would be problematic. One way to increase support, and to reduce administrative costs as well, would be to follow the politically successful program of subsidy for homeownership by using the Internal Revenue Service (IRS) to determine eligibility and to distribute the benefits.

Currently, the multibillion dollar subsidies to home ownership in the U.S. are distributed largely by the IRS. Individual taxpayers need not report the dividend (i.e., the imputed rent) on owner-occupied housing at all, and capital gains on sale are accorded special treatment in the

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[4] Indeed, the recent analysis of the MTO experiments by Kling, Lieberman, and Katz (2007) concludes that these treatments pass the cost-benefit criterion because "the MTO intervention[s] produced large mental health improvements and *because other research suggests that it is cheaper to provide a unit of subsidized housing with vouchers than in a public housing project.*" (2007, p. 108, emphasis added)

computation of tax liability (on Schedule D, by following the instructions on Worksheet 2). The distribution of these large subsidies ($29.7 billion in 2006 from the imputed rent exclusion and $39.8 billion from the capital gains exclusion) is relatively painless. However, the subsidies provided under the tax laws for owner occupants are not refundable to the taxpayer. Instead, the subsidy is paid implicitly as a credit against other tax liability.

In contrast, the Earned Income Tax Credit (EITC) is fully refundable to the taxpayer. Eligibility for the credit can be established on-line (at apps.irs.gov/eitc2005, for example). Alternatively, the IRS will establish eligibility and will compute the credit due -- and they will also send along a check -- to any qualifying taxpayer. A refundable credit is not hard to administer.

In fact, there is already a housing program administered by the IRS that could be the template for this low-income housing subsidy program. The Mortgage Credit Certificate (MCC) Program authorized by the Deficit Reduction Act of 1984 entitles selected homeowners to claim a tax credit for some portion of the mortgage interest paid in any year, rather than the tax deduction afforded other homeowners. (See Greulich and Quigley, 2003, for a detailed discussion.) A taxpayer in possession of an MCC issued by a unit of state or local government merely checks a box on her tax return (on line 54 of Form 1040) and submits a brief form (Form 8396, 11 lines long) to claim the nonrefundable credit.

To claim the low-income housing subsidy under the program proposed here, the taxpayer would need to submit a form issued by a local housing authority and check a box added to the current IRS Form 1040. The form would simply certify that the household was renting a dwelling meeting the minimum habitation standards imposed by the current voucher program. That form, together with the income reported by the household, the number of dependents in the household, and the postal address of the household would be sufficient to compute the credit due any household. The computation could be made by any taxpayer (on-line) or by the IRS, as is the case of the EITC. Of course, the computations could also be made by H&R Block or by any other commercial tax preparer. The private sector would have an incentive to help in the administration of the program.

The appropriate credit could be mailed in monthly installments to the low-income household, or to her landlord (or to the local housing authority, for that matter).

V. Details

Of course, there are myriad details to be addressed before this sort of reform could be implemented. Households move during the year, and a changed postal code might entail a different FMR and AMI. Children are born; dependents are added. This means that settling up the monthly rent entitlement on an annual basis requires careful administration and attention to detail.

And then there is a question of costs. The precise costs to the treasury depend upon two factors: the income cut-off for assistance and the payment standard employed. The income cut off is conventionally represented as the ratio of household income to area median income (both adjusted for family size.) The payment standard under the current voucher program is the HUD-computed fair market minus thirty percent of income.

Table 5 presents historical data from the “worst case housing needs” reports for very poor renter households. As the table indicates, there was an increase in the percent of low-income households (i.e., those with incomes less that half the local median) paying more than half of their incomes in rent during the decade of the 1980s, from 30 to 38 percent between 1978 and 1989. The percentage of these very low-income households spending more than half of their incomes on rent has remained roughly constant, at 38-39 percent, since the late 1980s. (These trends are confirmed using Census data for renter households with incomes below the poverty line. See Quigley and Raphael, 2004.) For 2001 and 2003, these “worst case” reports also indicate that rent expenditures among households earning less than thirty percent of the area median are about 55 percent of income.

The table also reports the fraction of these households assisted by low-income housing programs. This fraction increased between 1978 and 1989 and remained roughly constant at 27-29 percent since. The table also reports the fraction of these low-income households who could have been assisted if all rental housing assistance had been targeted to these households. As the table indicates, increased targeting would have increased the population of assisted households, among those with less than half of local median income, by six percentage points in 1995 and by about twelve percentage points

Table 5. Rent Burdens and Subsidies for Low-Income Renters 1978-2003

	Households with incomes below 50 percent of AMI						Households with incomes below 30 percent of AMI	
	Year						Year	
	1978	**1989**	**1995**	**1997**	**2001**	**2003**	**2001**	**2003**
A. Number (thousands)								
Renter Households	10,682	13,378	14,562	14,519	14,903	15,658	8,659	9,077
Spending > 50% of income on rent	3,226	5,056	5,927	6,395	6,022	6,105	4,838	4,945
Assisted Households								
Incomes below cutoff	2,094	3,933	3,772	4,077	4,234	4,256	2,942	2,986
Others	633	145	876	1,531	2,044	1,956	3,336	3,226
B. Percent								
Assisted Households								
Actual	19.6	29.4	25.9	28.1	28.4	27.1	34.0	32.9
If targeted	25.5	30.5	31.9	38.6	42.1	39.7	72.5	68.4
Spending > 50% of income on rent								
Actual	30.2	37.8	40.7	44.0	40.4	39.0	55.9	54.5
If targeted	24.3	36.7	34.7	33.5	18.0	26.5	17.3	18.9

Source: US Department of Housing and Urban Development, Office of Policy Development and Research, *Rental Housing Assistance--The Worsening Crisis. A Report to Congress,* March 2001; *A Report on Worst Case Housing Needs in 1999*, January 2001; *Trends in Worst Case Needs for Housing, 1978-1999,* December 2003; *Affordable Housing Needs: A Report to Congress on the Significant Need for Housing*, 2005.

in 2003. Finally, the table reports the fraction of households in this category spending more than half their incomes on rent if housing assistance had been targeted to the class. The reduction in those spending more than fifty percent of income on rent would have been about six percent in 1995 and about twelve percent in 2003. If this targeting were directed towards the very poorest of renters – those with incomes below thirty percent of area median – the fraction spending more than half of their incomes on rent could be reduced from about 55 percent to less than 20 percent.

Greater precision in the targeting of subsidies would increase program costs for the same number of households served, since lower-income households receive more assistance. Without detailed information on the distribution of households by income across housing markets, it is not possible to estimate the costs reliably for any expansion of a more targeted program. However, some crude information is available from the 2000 Census that may provide a very rough estimate of costs. The census provides a national tabulation of household incomes and rents paid (HCT56, from the SF4 sample data.) Those in classes with incomes below $20,000 are those whose incomes were below 32 percent of the national median income (in 2000, for a family of four), and those in the lowest reported class (less than $10,000) have incomes below 16 percent of the median.

If a tax credit were introduced to subsidize households with incomes below $20,000 a year by paying them the difference between their reported rents and thirty percent of their incomes, and if this voucher payment were made by the IRS to all qualifying low-income households, the cost would be about $22 billion (in 2006 dollars) for the households who received subsidies. (Of course this is an overestimate, since many households pay more than thirty percent of income on rent voluntarily in order to receive more or better housing.) If housing prices increased by ten percent as a consequence of the program, the cost would be about $26.2 billion in 2006.[5]

The rent subsidy program would provide assistance to about 8.0 million households with incomes below 32 percent of median household income, instead of assistance to 3.0 million households with incomes below 30 percent as was provided under current programs (in 2003). The additional 5 million very poor households served would cost about $4,400 each. But savings could be achieved by withdrawing subsidies (slowly, to be sure) from the 3.2 million higher

[5] If, instead, the credit were introduced for households with incomes below $10,000, it would cost $10.7 billion ($13.0 billion if rents increased by ten percent).

income households currently subsidized by rental assistance programs and by redirecting costly rental construction programs (e.g., the LIHTC, at $4.0 billion per year).

Of course, there is nothing sacred about a cutoff of 0.32 (or 0.30 or 0.16) of median income. Nor is there any particular normative significance in the definition or computation of FMR.[6] The budget (any budget) can be accommodated – as an entitlement, beginning with the poorest households.

The introduction of the rental housing subsidy program outlined above would not be sufficient to replace all existing rental housing programs or the collateral functions of the Department of Housing and Urban Development. The vigorous enforcement of equal opportunity in housing, for example, is a precondition to the functioning of an expanded voucher system as an entitlement program for low-income renters. Low-income disabled households have special needs that could not be satisfied by participation in an expanded voucher program. Some fraction of the homeless are not simply poor. They, too, are disabled and require housing in a supportive environment that can best be provided collectively by government. These considerations flow from recognizing that housing subsidies are better considered as a part of a welfare system, not an infrastructure investment program.

One aspect of current HUD activities would have to be increased substantially for this reform to be successful. Currently, HUD devotes some resources to the removal of “regulatory barriers” to the construction of new housing. Much of this activity consists of the identification of regulations and practices which increase housing costs, including zoning, building codes and administrative processes. More federal resources would have to be devoted to removing local regulation which drives up the cost of new construction (See Quigley, 2006, for a discussion).

In this proposed reform a big change, or just a minor tweak, to existing rental subsidy policy? Under current law, local authorities are required to provide three quarters of new rental subsidies to households earning less than thirty percent of local median income. This suggested reform would target a specific income cutoff and provide national entitlement to households of lower income. Under current policy, about three quarters of HUD housing outlays are for demand-side subsidies, and the long-term trend has been to reduce systematically the importance of construction and supply-side subsidies. This proposed reform would accelerate this trend and

[6] Indeed, the FMR was originally an estimate of monthly rent at the fortieth percentile of the rent distribution. It is now an estimate at the fiftieth percentile.

would eliminate construction subsidies, but perhaps not tomorrow. Current policy utilizes local housing authorities as the rationing agents for housing subsidy, a legacy of the public housing initiative of seven decades ago. This reform would apply a national standard to determine eligibility and to award the subsidy. Local authorities would continue to inspect dwellings and certify compliance.

The device of achieving this through the IRS and a refundable tax credit is clearly a gimmick, employed, in part, to place the subsidy off-budget and to avoid the annual appropriations cycle. But the gimmick has proven to be successful and effective for other interest groups, even in the allocation of subsidies for housing. It has worked quite well for upper-income homeowners and for builders.[7] It is worth trying for the poor.[8]

But the major barrier to this kind of reform would be the interests which would be offended by a simple and streamlined program providing vouchers as an entitlement. This is, of course, a major reason why "history matters" in the real world. On the one hand, some builders might not immediately see that such a program was really in their interest. On the other hand, some local governments who currently use rental housing subsidy money to build ambitious urban monuments would object to such a program. On the third hand, some government servants who were made redundant might object to the program. All these interests are important players in the world of housing policy, and their potential objections are to be taken seriously.

However, the economic problem is that housing is unaffordable to low-income households, and they face extremely high rent burdens. We should transfer resources to those households so they can live in decent housing at expenditure levels they can afford.

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[7] For example, of the 46,335,237 individual tax returns filed in 2004, 617,728 reported incomes in excess of $500,000. Of these, 421,141 reported home mortgage interest deductions totaling $11,245,360,000. (U.S. Department of the Treasury, 2006, Table 2.1) At prevailing federal tax rates, the home mortgage interest deduction for the richest 1.3 percent of taxpayers yielded a revenue loss of $7.3 billion. This is between a quarter and a third of the total cost of the entitlement described above for all renter households with incomes below $20,000.

[8] This device might also lead to a closer integration of housing subsidy policies and other parts of the welfare and income transfer system. See Fischer, 2000.

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