

# Improving Local Strategies for Housing the Urban Poor

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*This paper shows that regardless of whether the current Section 8 program is continued or whether an alternative program structure is adopted, housing assistance can be made more economical if there is greater reliance on the existing housing stock rather than on new construction. Greater reliance on existing housing would occur if there were a better match between local housing market conditions and housing assistance strategies. The findings have implications for both Section 8 and the proposed housing programs.*

*Section I of the paper describes the important role of Housing Assistance Plans (HAPs) in determining housing strategies for individual localities and for the nation. The second section asks whether the housing type mix expressed in the HAP goals is consistent with local housing market conditions. The best available evidence indicates that the housing mix between new and existing units does not reflect local market conditions. There is too much reliance on construction, particularly in soft housing markets. Three local impediments to the lack of an optimum housing mix in HAP goals are described in Section III. Next, the implication for housing block grants and housing allowances are discussed. The final section describes possible revisions in the way the housing assistance mix is determined.*

## **I. The Role of Housing Assistance Plans in Housing Assistance Strategies**

Both Congress and the new administration are reevaluating Federal housing programs primarily because of large and increasing costs. The Congressional Budget Office (1979) anticipates that

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costs will increase from the 1980 level of \$5 billion to \$9 billion by 1984, although recent cuts proposed by President Reagan will restrain the budget increases. In a period of fiscal retrenchment, housing programs are susceptible to budget cuts. Partly in response to budgetary concerns, housing block grants and housing allowances have been proposed as alternatives to the Section 8 program. The current planning process provides a starting point for analyzing ways to economize on housing assistance.

Housing Assistance Plans, summarized in Table 1, are local statements about housing conditions and need. They include information on the

number and type of low income families in need of housing assistance, the condition of the housing stock, and housing assistance goals. The function of HAPs that is most pertinent to encouraging economy in housing assistance is the determination of the appropriate housing assistance mix among new construction, substantial rehabilitation and the existing housing stock. At both the local and national level the housing mix is important because it is significantly cheaper to subsidize housing by using the existing stock rather than through rehabilitation or new construction. About 40 percent more annual contract authority is required to subsidize families in new or substantially rehabilitated units than in existing units (Congressional Budget Office, 1979). Contract authority does not represent the entire cost differential because new construction receives a 25-30 year subsidy commitment from the Federal Government whereas commitments for assistance in existing housing are only for 15 years. Consequently the cost differential based upon budget authority is even greater than 40 percent.

HAPs are not used to determine the amount of assistance dollars appropriated by Congress or allocated to particular cities. Since communities set their own goals and have their own concepts of need, the aggregation of HAPs cannot reflect a uniform standard of overall national need. The dollar amount of subsidies to localities is determined by a standard formula based on demographic and housing conditions and is not a function of the size of housing assistance goals. The variables used in the "fair share" formula are population, poverty, units lacking plumbing, extent of overcrowding, excess vacancy rate, and renters with special housing problems. The factors are weighted equally.

The use of the allocation formula has caused some observers to suggest that HAPs are not important in housing allocations (Vandell and Cox, 1978). However, this view ignores two important aspects of the budgetary process. First, the aggregation of local HAPs plus housing needs estimated for non-HAP areas (weighted by their fair

**TABLE 1. — A Summary of Housing Assistance Plans**

**A. Survey of Housing Conditions**

Housing units available in the city are tabulated. Available units are cross-tabulated by tenure (rental, owner) and vacancy status. Estimates of the number of substandard units and whether the substandard units can be rehabilitated are included.

**B. Housing Assistance Needs of Lower Income Households**

Assistance needs are estimated for households earning less than 80% of the SMSA median. Separate estimates are made for (a) elderly and handicapped, (b) small families (four or less), and (c) large families. Needs of minority and female-headed households are broken out for separate description. Estimates of the housing needs of each group are tabulated by owner and renter households.

**C. Three Year Housing Program, Three Year Goal**

The number of assisted housing units to be provided over a three year period for elderly and handicapped, small families, and large families are set forth. The goals are further broken down by tenure (rental, owner) and whether the assistance will be through new construction, substantial rehabilitation, or the existing housing stock.

**D. General Location for Proposed Housing**

A general description of where newly constructed and substantially rehabilitated units will be located is provided. (This is the most controversial table because of potential neighborhood opposition to nearby subsidized housing. Consequently, locations are seldom specific). An explanation of the site selection criteria is also given.

**E. Annual Housing Action Program**

Similar to Table III except that the goals are set for the coming year rather than a three year period.

share formula amounts) serves as the basis for HUD's requests to Congress for housing assistance contract and budget authority. The housing type mix is an important element in HUD's justification of its budget request. After Congress has

**TABLE 2. — HAP Goals, Budget Requests, and Net Reservations**

Fiscal Year	HAP Goals	NEW		REHABILITATION			EXISTING		
		HUD Request to Congress	Net Reservations	HAP Goals	HUD Request to Congress	Net Reservations	HAP Goals	HUD Request to Congress	Net Reservations
1977	41*	39	43	13*	4**	7	46*	57	50
1978	46*	51	39	13*	6	8	40*	43	53
1979	49	39	44	17	20	13	34	41	43
1980	51	49	48	14	17	12	35	34	40

\*For entitlement cities only

\*\*Excludes Indian Housing and Section 8 units set aside for adding rent supplements to troubled HUD insured housing. Source: Struyk and Khaddri and Economic and Market Analysis Division, Department of Housing and Urban Development.

approved a housing appropriation, HAPs (Table 1, parts C and E) are used to allot housing to housing allocation areas.

Table 2 shows the relationship between the percentage of housing types requested in the HAPs and HUD's budget request. It also shows that housing mix reservations, which are housing assistance commitments, approximate the HAP goals. The associations are not exact and the number of annual observations is small, so generalizations must carry the obvious caveats. However, the data indicates a reasonably close relationship between HAP goals, HUD requests, and assistance reservations. The Fifth Annual Community Development Block Grant Report drew a similar conclusion (Office of Evaluation, 1980).

Evidence that aggregate housing assistance reflects the sum of HAP mix goals leads to a second question. Is the local HAP mix related to the type of assistance provided locally? Even if HAPs affected national policy, they need not necessarily affect allocations to individual cities. The Housing and Community Development Legislation requires that HUD allocate housing units in accordance with the Housing Assistance Plans to the maximum extent practicable. (Basic Laws and Authorities, 1979). But legislative requirements are not always reflected in outcomes.

In order to examine the association between HAP housing mix goals and accomplishments, the percentage of 1976 three-year HAP goals for new construction was correlated with the percentage of 1975-79 commitments for new construction. For a sample of 21 cities, the correlation was .70 and was statistically significant at the one percent level. The correlation supports the contention that HAPs affect the type of housing assistance received by local areas.

The conclusion of this section is that Housing Assistance Plans have an effect upon the housing mix at both the local and national levels. Consequently a shift in local HAPs that increases the use on existing housing would probably be reflected in lower per unit costs.

## II. The HAP Mix and Housing Market Conditions

The HAP concept is based upon the premise that local housing markets vary so widely that two areas with equal need may require different approaches to housing assistance. The logic of the HAP process is that HAPs should reflect local housing market conditions. If they do not, then they may lead to housing activities at the local level that waste resources. This section examines several empirical studies and concludes that

HAPs do not reflect local housing market conditions and would be more economical if they did.

### Market Conditions and Housing Strategies

A brief description of the theoretical relationship between housing market conditions and the appropriate housing mix should preface a review of empirical evidence.

A presumption exists in the theoretical literature as well as in HUD regulations that housing goals in soft markets should emphasize the existing housing stock because there is not a sufficient demand for new units at the current price. In tight markets new construction should be a more important strategy because there is pressure on the existing housing stock.

Figure 1 illustrates the dynamics of a typical soft housing market in a low income area. Starting with a reasonably stable situation (equilibrium does not mean static) some change decreases the demand for housing. Demographic change, real income declines and preference changes are the principal reasons for the initial disequilibrium.

Some property owners will earn less than they anticipated as vacancy increases and rent declines affect the cash flow. The more dominant the effort on the part of property owners to maintain rent levels, the greater will be the increase in vacancies. Since prices normally fall slowly and during inflationary periods real rents decline even when nominal rents are constant, prices might increase slowly rather than actually decline. The stock of housing will decrease as low prices discourage private construction. Abandonment also characterizes soft markets because prolonged vacancies and postponement of repairs lead to severe deterioration. Whatever private construction or major rehabilitation may have been planned will be cancelled, postponed, or reduced.

There are two reasons that the lack of a significant relationship between any particular indicator of market conditions and the HAP housing mix may not be sufficient to prove definitively that the mix does not adequately reflect local housing

**FIGURE 1. — Dynamics of a Soft Market for Low Income Housing**



conditions. First, housing markets may be segmented to such an extent that the area-wide vacancy rate misrepresents the market for low and moderate income housing. For example, a city-wide vacancy rate of 7 percent for a city might be the combined result of a 10 percent vacancy rate among luxury units and a 1 percent vacancy rate in low income areas. Second, some cities may have unique neighborhoods that warrant new construction even though the market is soft. Consequently, statistical evidence that there is no relationship between a particular market indicator and a HAP mix is inconclusive. The more robust the analysis, the more confidence we can place in an empirical conclusion.

## Empirical Studies

Three empirical studies have examined the relationship between HAP mix goals and local market conditions. Although they have employed widely different techniques, none have shown any consistent relationship between housing markets and strategies.

The relationship between the 1976 HAP goals and housing market conditions for 27 cities was examined by Olsen and Rasmussen (1979). They tested the proposition that new construction should be proportionally less in cities with soft markets. Housing market conditions in the metropolitan area as well as the central city were examined because suburban conditions could affect the appropriate housing mix in the central city. Indicators of soft markets included long vacancy durations, high overall vacancy rates, and high rental vacancy rates. The results are shown in Table 3.

The relationship between indicators of market softness and the proportion of new construction in the HAP goals was frequently consistent with the proposition that there should be less construction in soft housing markets. However, the associations were weak and not statistically significant. The coefficients of determination ( $R^2$ s) are low. Even in the model with the greatest explanatory power, market conditions accounted for only 28 percent of the variation in the HAP housing type mix. Thus, housing market indicators did not explain a significant amount of the variance in the use of new construction.

To supplement the multiple regression, simple correlations were examined for a set of 21 cities.<sup>1</sup> The housing market indicators employed were the renter vacancy rate, percent of units abandoned, percentage increase in gross rents, and the percentage change in rental households. The findings are summarized in Table 4. Only one of the relationships is statistically significant. Rehabilitation is negatively associated with the change in rental households and in this case the relationship is theoretically ambiguous. None of the other associations were statistically significant. In fact, about half do not even have the theoretically ex-

pected sign.

The empirical findings indicate that local market conditions do not explain the HAP assistance mix. However, local housing plans may not correlate with the indicators of market tightness and may still be reasonable if the available housing types are unsuitable for the families in need of assistance. Nor does the lack of correlation prove that the imbalance results in too much new construction because lack of a statistical association could also occur if tight markets were relying too much on existing programs. But neither possibility appears to be the case.

Recent case studies of four soft housing markets by the HUD Office of Policy Development and Research (PD&R) (1980) strongly suggests that there is too much reliance on new construction in soft markets. The case studies of St. Louis, Cleveland, Detroit and Pittsburgh included variables that either could not be quantified or were not available for a large enough number of cities to permit statistical tests. In addition to overall market indicators, the analysts examined displacement, the condition of the housing stock, and market conditions in neighborhoods receiving housing assistance.

The analysis uncovered substantial reliance on the most expensive housing assistance strategies — new and substantial rehabilitation — in each city. Detroit, for instance, planned to provide only 35 percent of its assistance through the existing stock between 1976-79. Yet in 1976, the city had an 11.3 percent vacancy rate, a 5.7 percent abandonment rate and an 8 percent decrease in the number of rental households. The study concluded that: (PD&R, 1980)

“there appears to have been an excessive reliance on the construction of new multi-family rental housing during fiscal 1975 to 1979.”

The study strongly supported the contention that there is potential to improve Federal housing programs by increasing reliance on existing programs. In each case detailed analysis of market conditions failed to show a rationale for the reliance on new and substantial rehabilitation in housing assistance strategies.

**TABLE 3. — Four Regression Models With Ratio Of New to Total Construction Goals As Dependent Variable**

Explanatory Variables	Dependent Variable: PNG			
	Model 1	Model 2	Model 3	Model 4
DVPCC5	-.78* (.43)			
RVRCC5		-2.31 (1.40)	-2.91 (2.68)	-2.91* (1.71)
OVRCC5			1.02 (3.83)	
RVRSUB5				-3.52 (2.16)
OVRSM5				8.05* (4.39)
PRCCD	.24 (.23)	.23 (.24)	.21 (.26)	.11 (.24)
YR5	.08 (.10)	.04 (.10)	.04 (.10)	.02 (.10)
Constant	.53* (.13)	.53* (.14)	.50* (.16)	.33* (.17)
R <sup>2</sup>	.18	.16	.16	.28
F-statistic	1.63	1.43	1.05	1.62
F <sub>.10</sub>	2.33	2.33	2.19	2.10
(N= 27)				

Note: The numbers in parentheses are estimates of the standard deviations of the parameter estimators.

\*Significantly different from zero at .05 level using a one tail test.

#### Definitions of Variables

PNG	= ratio of all new construction goals to total goals
DVRCC5	= average duration of vacancy for rental housing in the central city
RVRCC5	= rental vacancy rate in central city
OVRCC5	= overall vacancy rate in central city
RVRSUB5	= rental vacancy rate in suburbs
OVRSM5	= overall vacancy rate in SMSA
PRCCD	= proportion of rental units in central city with structural deficiencies
YR5	= 1 if year is 1975; 0 if 1974.

**TABLE 4. — HAP Mix and Housing Markets**

HAP Goals	Housing Market Indicator			
	Renter Vacancy Rate 76	%Abandoned 1978	%Change In Gross Rents 1970-76	% Change In Rental Households 1970-76
New as a % of total 1976 3 yr. goals	.21	-.18	-.07	.27
Existing as a % of total 1976 3 yr goals	.26	-.21	.34	.12
Substantial Rehab as % of total production 1976 3 yr goals	-.23	.04	-.23	-.71F

F = Statistically Significant

### III. Impediments to an Optimum Housing Mix

The previous section described the lack of association between HAP housing mix goals and local market conditions. It suggested that there was potential to improve the housing assistance program by increasing the use of the existing housing stock. This section describes three explanations for under-utilization of the existing stock.

#### Conflicting Objectives

Federal-local goal conflicts are a perennial intergovernmental relations problem. Frequently localities use the housing program to pursue goals other than providing affordable housing to as many low income families as possible. The multiple objectives drive a wedge between the use of the existing housing stock and local market indicators.

One related local benefit of construction compared to reliance on existing housing is greater job creation. The benefits of job creation occur in the short run so the benefits will help political incumbents. Consequently, some political officials may choose to emphasize job creation and, therefore, tilt their HAP mix towards construction. The incentive to encourage new construction in order to

create jobs will be particularly great in cities with soft housing markets because soft housing markets are usually associated with high unemployment in the building trade. The fact that some of the jobs generated by construction may go to non-residents diminishes but does not negate the job creation incentive. New construction is also more visible than existing housing assistance, so it enhances local perceptions that "something is being done." Even if the construction is not widely recognized as an assisted project, its symbolic impact may be significant. A third reason new construction may be favored over use of the existing stock is because community development plans may target particular areas for redevelopment. Perhaps the city has condemned abandoned dwelling units that are not suitable for rehabilitation. Developing the area may be considered important in preventing the spread of blight. Likewise, new construction could help to anchor an area that is not blighted. Finally, new construction has been used as a tool for integrating neighborhoods.

#### Inappropriate Incentives

The problem of conflicting goals is exacerbated because communities do not face the appropriate trade-off between existing housing support and

new construction. Even if the local objectives associated with new construction were the same as Federal objectives, cities should be required to trade-off existing units for new in proportion to the present value of the budgetary authority (which reflects costs over the life of the subsidy) required to support them. Instead, the Federally imposed trade-off is based upon short-term contract authority. Based upon present value of budgetary authority, a city should give up about 2.4 units of existing housing assistance for each unit of construction. But the current contract authority trade-off is only 1.8 units of existing assistance per unit of new.<sup>2</sup>

Some local officials place a value on getting as many Federal dollars as possible. Such an objective alone could distort the assistance mix in favor of construction. It should be noted that the local impact of the long-term budgetary authority associated with construction accrues primarily when investors spend money to construct the project. Thus the local impact of the larger budgetary authority is not spread equally over the life of the project.

Many communities face an additional distortion in the relative costs of new and existing units because funds are distributed to allocation areas whereas goals are set for HAP areas. A city that is part of a larger allocation area will not even face the full trade-off reflected in the contract authority. If a city is part of a larger allocation area, some of the extra costs of new construction will be reflected in smaller allocations to other cities in the allocation area. Again the incentive system encourages over-reliance on construction.

Since there are local benefits from the use of new construction and since the real costs of construction are not reflected in the trade-offs faced by localities, the incentive system encourages too much construction and too little reliance on the existing stock. While moral suasion by HUD officials may have some ameliorating influence, the fundamental problem of inappropriate incentives remains.

### **Insufficient Attention to HAP Goals**

Another explanation for the lack of a relationship between market conditions and HAP mix goals is that HAPs are not taken seriously by local planners. The idea that HAPs are only a paper game is frequently suggested in the literature (Struyk and Khaddri, 1980). Since HAPs are only one part of a larger Community Development Block Grant application and since cities have more flexibility in spending Block Grant Dollars than housing allocations, policy attention tends to focus on the discretionary aspects of the application. If HAPs are not carefully developed to reflect local housing markets, then the random relationship between the proposed assistance mix and local market conditions would not be surprising.

A study of HAPs by the Berkeley Planning Associates (1978) indicated that principal local officials were seldom involved in developing housing strategies. Their study indicated that the chief executive of a city was actively involved in the planning of housing assistance in only 4 of the 36 cities studied.

Further evidence that HAPs are not carefully thought out is also suggested by the HAP study by the Working Group for Community Development Reform (1980) in which HAPs for thirty-six entitlement jurisdictions were analyzed by local monitors familiar with housing and community development. Significant errors were found in thirty-two of the HAPs they examined. The accuracy of estimates of housing conditions, an important element in determining the housing type mix, was found to be incorrect or at least problematic in thirty-one of the thirty-six jurisdictions monitored. This error rate is clearly too high in light of the critical role HAPs play in the allocation process and indicates that they are not a high priority document.

### **IV. Implications For Housing Block Grants and Housing Allowances**

The finding that housing assistance is not con-

sistent with local housing market conditions has important implications for two widely publicized alternative housing programs, housing block grants and housing allowances. The purpose of this section is not to provide a complete evaluation of either proposal but rather to show that the issue of the appropriate housing mix remains to be addressed in both proposals.

Congress has required HUD to study and report on the advisability of substituting a housing block grant for the current Section 8 program. Under the block grant proposal, communities would receive a formula-determined amount of money to spend on housing assistance. In keeping with the block grant concept, local officials would select the appropriate housing mix.

A housing block grant would reduce the problem of inappropriate federal incentives that encourage new construction because the present value of the federal resources would not be linked to the housing mix. However, the block grant would not assure an appropriate housing mix because the problem of conflicting goals would remain. Communities could still use housing to achieve employment and community development objectives that are not consistent with the objective of providing housing to low income families.

A revised HAP document could be used in the housing block grant application in a way that is similar to the current Community Development Application. In particular, the HAP could still be required as part of the application, but it would be strictly a local planning document. Its role in determining the national housing mix approved by Congress would be abolished because under the block grant concept Congress would no longer set a specific national housing assistance mix.

The housing allowance program would replace the present system with direct grants to poor families. The stipends are intended to be used for housing although in practice it is difficult to prevent families from using some of the housing allowance for non-housing purposes. The role of cities would be eliminated or reduced to that of an

administrative agent. The housing mix would be determined as an outcome of the choice of the recipients.

The housing allowance program will mean that a much larger proportion of housing assistance would rely upon the existing stock. A recent evaluation of an experimental housing allowance program concluded that the payments would not be large enough to induce recipients to purchase or rent newly constructed units (U.S. HUD, 1980). Thus new construction might be minimal even in tight housing markets and neighborhoods where it is needed. Thus, a strategic tool in selected markets would be lost. Furthermore, the housing needs of some groups such as the elderly and handicapped cannot be served adequately by the existing stock. Therefore even housing allowances may need to be supplemented with a new construction program for some groups and in some parts of the city.

## V. Policy Implications

The principal conclusion is that the housing assistance mix does not reflect local housing market conditions. In particular, it does not reflect the potential for using the existing housing stock. Three explanations for the under-utilization of the existing stock were conflicting objectives, inappropriate incentives, and insufficient concern with the HAP process.

Three mutually reinforcing HAP reforms follow from the explanations for the under-utilization of existing housing. First, in order to address the problem of conflicting goals, localities should be required to justify rigorously variations from the most economical housing type mix. Second, HUD should charge cities the present value of estimated future outlays rather than contract authority in order to make the relative costs to localities proportional to the relative cost faced by the Federal government. Finally, in order to encourage greater interest in HAP development, bonus allocations could be provided to localities that develop economical assistance plans.

HAPs could serve an important role in implementing each of the three options. If the first option were pursued, HAPs could be the documents where justification for a housing mix emphasizing new construction could be stated. If the second option were pursued, the HAP could serve as the document that makes the trade-offs explicit. The third option would focus HAPs directly on the best way to spend housing assistance economically.

Improving the association between housing types and market conditions will be important even if the housing block grant were substituted for the current housing program because communities will have the same allocation problem. A modified HAP could serve as a strictly local planning device under a block grant program. A HAP-like process may also be necessary to insure that legitimate needs for new construction are recognized in a housing allowance program.

All of the major studies of housing assistance allocations have affirmed the potential usefulness of HAPs in spite of specific HAP shortcomings. According to Nenno (1980):

“on one subject most interests appear to agree — the HAP can be a valuable mechanism and is worth saving.”

The reforms suggested here should be important steps in saving HAPs.

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### Notes

1. The correlations were calculated by Mike Gleeson.
2. The cost trade-offs are based upon 1981 budget estimates. U.S. Department of Housing and Urban Development, *Justification for 1981 Estimates Part I*, March, 1980. A discount rate of .10 was used to calculate the present value of the budget authority. The length of the commitment is 25 years for new and 15 years for existing. Since some new units received budgetary authority based on 30 years, the 2.4 cost trade-off may understate the true budgetary authority exchange rate.