

GAO

Staff Study

August 1989

HOUSING CONFERENCE

National Housing Policy Issues



Preface

GAO's Housing and Community Development issue area deals with the federal government's role in several endeavors that aid in building and maintaining the economic and social foundation of our society. For example, the government has played an important role for many years in ensuring and providing an adequate and affordable supply of decent, safe, and sanitary housing for many citizens. However, since 1980, federal funding for housing programs has been reduced substantially for some programs, and others have been targeted for further reduction or even elimination.

The Congress and the administration have begun to emphasize the need for immediate attention to programs that would provide an adequate and affordable supply of housing, including housing for the homeless. Therefore, it is important for GAO to target its planned work to issues of availability and affordability of housing that will be of most benefit to policymakers in their deliberations over actions needed to help our nation's housing programs.

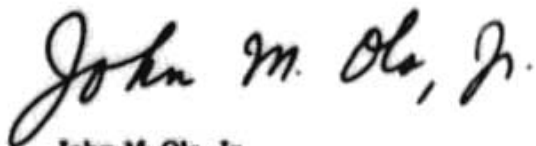
To assist in this planning, on September 13-15, 1988, GAO's Resources, Community, and Economic Development Division sponsored a conference to discuss the problems of availability and affordability of housing for low-income households, homeless individuals and families, and first-time home buyers. The major issues discussed during the conference were

- the availability and affordability of low-income housing,
- the growing homelessness problem, and
- home ownership assistance needs.

This staff study is a transcript of the proceedings of the conference. We made minor editorial changes for clarity.

Subsequent to our planning conference, numerous issues emerged that have identified mismanagement of Department of Housing and Urban Development (HUD) programs. Therefore, in addition to the policy areas

discussed in this staff study, GAO plans to examine the internal controls of various HUD programs and make recommendations that will correct any mismanagement identified.



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GAO/RCED-89-174 Housing Conference

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Table 5.1: Comparison of Housing Outlays to Tax Expenditures

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Abbreviations

AFDC	aid to families with dependent children
ARM	adjustable rate mortgage
ARMs	adjustable rate mortgages
CDBG	Community Development Block Grant
CDC	community development center
CHAP	Comprehensive Assistance Program
CHAPs	Comprehensive Assistance Programs
FHA	Federal Housing Administration
GAO	General Accounting Office
HAPs	housing assistance plans
HHS	Department of Health and Human Services
HOLC	Home Owners Loan Corporation
HOP	Housing Opportunity Partnership
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget
PHA	public housing authority
PHAs	public housing authorities
VA	Department of Veterans Affairs

Summary

Introduction and Opening Remarks

The conference participants were welcomed by the Honorable Charles A. Fowsher, Comptroller General of the United States, who explained the purpose of the conference and emphasized the importance of GAO's work in the Housing and Community Development issue area. Mr. Fowsher introduced the keynote speaker, the Honorable Henry B. Gonzalez, Chairman, Subcommittee on Housing and Community Development, House Committee on Banking, Finance and Urban Affairs. Congressman Gonzalez spoke on the problems of (1) owning or renting affordable housing, (2) maintaining and constructing low-income subsidized housing, and (3) creating and coordinating programs to assist the growing number of homeless Americans.

Four speakers from the Department of Housing and Urban Development (HUD) concluded the opening remarks portion of the conference. The speakers were

- Paul Adams, Inspector General, who spoke on key housing issues and the Office of Inspector General work plans;
- Donald Keuch, Deputy Assistant Secretary for Administration, who spoke on HUD's management initiatives and key management issues facing the new Secretary;
- Kim Couture, Deputy Assistant Secretary for Legislation and Congressional Relations, who spoke on HUD's implementation of the 1987 Housing Act and proposed housing legislation; and
- Chris Moore, Office of Assistant Secretary for Legislation and Congressional Relations, who spoke on legislation before the Congress dealing with ways to increase home ownership opportunities.

Panel Discussions

The conference moderator, Dr. Anthony Downs, Senior Fellow, Brookings Institution, began the panel discussions by summarizing his views on the nation's major housing problems. Dr. Downs identified problems related to (1) a worsening shortage of low-rent housing units that low-income households can afford, (2) preserving the current inventory of low-income subsidized housing units, (3) rehabilitating and effectively managing public housing, (4) high housing prices that reduce the affordability of home ownership, and (5) defining the relative roles of the Federal Housing Administration (FHA), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Association (Freddie Mac), and the thrift industry.

The three main issues that the panelists addressed were

- affordability and preservation of low-income housing,
- homelessness assistance, and
- home ownership assistance.

Affordability and Preservation of Low- Income Housing

The first panel in this area dealt with maintaining and preserving the current supply of low-income public housing and consisted of

- Gordon Cavanaugh, Legislative Counsel to the Council of Large Public Housing Agencies and former Administrator of the Farmers Home Administration and
- Dr. Michael Stegman, Professor and Chairman, Department of City and Regional Planning, University of North Carolina.

The second panel in this area dealt with rental assistance for low-income households and consisted of

- Cushing Dolbeare, Consultant on Housing Policy and Programs and
- Michael Hanratty, Executive Director, Fort Worth Housing Authority.

The conference speakers basically agreed that the supply of rental housing that is available and affordable to low-income people is shrinking while the demand for such housing is increasing. They concluded that the nation faces a substantial need for housing assistance to low-income families.

Among the major points made by these speakers were the following:

- The government should resume large-scale production and modernization of public housing.
- There is a need for HUD to carry out a program to provide service to public housing residents to ensure the successful transition of such residents to private housing.
- If HUD truly believes that tenant management is more cost-effective than conventional management and will save substantial money over the long term, then it should seek substantial funding for a major tenant-manager program as an investment that will return major dividends in the future.
- The extent of racial segregation in public housing must be addressed.
- Local public housing authorities' (PHAs) experimental approaches for evicting drug dealers without violating due process of law should be monitored and assessed for effective development.

- HUD should develop a comprehensive approach to dealing with chronically troubled public housing projects.
- A significant amount of funding is necessary to modernize public housing—probably as much as \$18 billion.
- The nation needs to choose between new production of low-income housing and a focus on tenant-based subsidies.
- If vouchers replace certificates, fewer units will be available, assuming the same level of funding.

Homelessness Assistance

The third panel dealt with solving the homelessness problem and consisted of

- Dr. Langely Keyes, Professor of City and Regional Planning, Department of Urban Studies and Planning, Massachusetts Institute of Technology;
- Dr. James Stimpson, Deputy Assistant Secretary, Office of Policy Development, Department of Housing and Urban Development;
- John Sidor, Executive Director, Council of State Community Affairs; and
- Morris Bourne, Director, Office of Transitional Housing, Department of Housing and Urban Development.

The context for the participants' comments was the recently enacted Steward B. McKinney Homeless Assistance Act, which authorized a number of federal programs directed at alleviating the immediate needs of the homeless and/or seeking longer term solutions to the problem. Although the panelists acknowledged that many federal programs are assisting the homeless, there was some question as to how well this assistance is coordinated.

Major issues raised by these speakers included the following:

- The federal government must encourage, help, or do whatever it can to create a system in which it reinforces state and local efforts to deal with the homeless.
- There is a need for coordination between welfare issues and housing issues.
- Homelessness is not only a housing problem, but a problem of mental disorder, drug abuse, and other social problems.
- The McKinney Act is too complicated, has too many separate programs, and requires too much coordination.
- The McKinney Act does not address longer term support services or permanent housing. For example, there is nothing in the act addressing the particular problems of the homeless youth or the homeless with AIDS.

- The McKinney Act does not provide sufficient funding.
- Any program passed by the Congress that is designed to address the homelessness issue should have some of its funds eligible for the prevention of homelessness.
- Funds available for transitional housing are not sufficient and are not being fully used by states.

Home Ownership Assistance

The fourth panel dealt with home ownership assistance and consisted of

- Dr. Patric Hendershott, Galbreath Professor of Finance, Ohio State University and
- Philip Brownstein, Brownstein, Zeidman, and Schomer, and former Commissioner of the Federal Housing Administration.

The general consensus was that there is some question as to the stability of the financial status of the FHA mortgage insurance fund. Given this question, it is even more uncertain as to what actions should be taken to aid potential home buyers because certain actions, if taken, could further harm the stability of the FHA fund.

Major issues raised by these speakers included the following:

- The financial stability of the FHA insurance fund.
- The need to alter FHA programs or other federal programs to provide greater assistance to potential home owners.
- Whether FHA regional loan limits should be related to regional house prices.
- Competition between the federal government and private insurers.
- The use of federal tax policies to support and stimulate housing.

Introduction and Opening Remarks

Remarks of the Honorable Charles A. Bowsher, Comptroller General of the United States

Mr. Bowsher: Housing is an area in which the government has not devoted the resources it once did, as a percentage of our budget and our gross national product, and it shows around the country. This is an area that we have to give more attention to in the coming years. It's one that GAO is going to allocate more staff to, so the important thing is to know what jobs we should be working on, and what areas we should be giving the most attention to. That's why I like to see these kinds of conferences—conferences where we come together and talk about the issues, but also get some outsiders to come in and give us their advice and counsel on these issues.

And so today we're very pleased to have with us Congressman Gonzalez. Congressman Gonzalez has had a great career representing his own constituency and district as well as being a leader on the national scene in many areas, including the housing area. In fact, he's been involved and a leader in every major piece of housing legislation that has gone through the Congress in recent years. It's my great pleasure now to introduce him, and tell him how much we appreciate his taking the time out of his busy schedule to address our group.

Congressman Gonzalez, we're very pleased to have you here today.

Remarks of the Keynote Speaker, the Honorable Henry B. Gonzalez, Chairman, Subcommittee on Housing and Community Development, Committee on Banking, Finance and Urban Affairs, House of Representatives

Congressman Gonzalez: Thank you very much Comptroller General Bowsher, Mr. Luke, Dr. Downs, and all other distinguished guests.

Ladies and gentlemen, thank you very much for this chance to be with you this morning. I particularly wish to express my appreciation to those who have put this conference together.

In anticipation of this conference, I've prepared some words, and I think I had better stick to them. I was in the State Senate of Texas for 5 years, some 32 years ago, and I was kind of lost there for a while, but I soon discovered, to undying glory, that the Texas Senate is the birthplace of the unlimited debate precedent. It's not the U.S. Senate, it's the Texas Senate. The filibuster is a weapon that you can develop if you have the

ability to stand up and talk until you drop dead, or they adjourn the Senate. So I learned to get on my feet and hold up everything for about 30 hours. But the bad part about that is I had to develop the skill of saying in 30 hours what I could have said in 3 minutes. I'm still, 35 years later, trying to get over that habit. So I had better stick to the subject matter that was assigned to me.

I want to thank Mr. Luke for his insightfulness in this very, very critical issue of shelter or housing in our country today. If you're a typical group of Americans, slightly less than two-thirds of you are buying the place you live in. Of those who are buying homes, the overwhelming majority will be two-income families—sometimes by choice, but nearly always out of necessity. Here in Washington, it takes an average annual income of \$38,300 to afford the average new home, but the average annual income of a worker here is \$14,000 less than that. Here, and in just about every city of the land, the story is the same. If you want to buy a home you have to have two incomes. But if you're less than 35 years of age, you might not be able to buy a home even with two incomes.

Just 8 years ago, more than half of all first-time home buyers were under the age of 35. Today, only about 45 percent of first-time buyers are that young. The fact is that fewer Americans of any age can afford to buy a home today. And that underestimates the problem. Among those most likely wanting to buy—those who are under 35 years of age—the rate of home ownership has dropped three times as fast as the overall average, and that's just in about 8 years.

Now, how can this happen in an era that we have been assured is generally prosperous? Why is it that in city after city those skilled people—who construct our buildings, manage our governments, police the streets, teach the kids, and make and sell the goods we use—cannot afford a decent home? Why is it that those with less skill and humble jobs can't afford a place to rent? Why? And what can we do about it?

For decades this country enjoyed vast progress in housing. In fact our country performed a miracle between 1940 and 1980. In 1940, somewhere between 63 and 65 percent of our homes were inadequate. By 1980, only 6 percent were. But inadequate housing has doubled in the last 8 years. So how can that happen? Until recent years, the Congress and the people made commitments, made national commitments. And every country in the world that has attempted to house its citizens has to first develop a national commitment. But we're now in the throes of a

collapse of the financial system that was the foundation for our national commitment. The financial framework of reference that made it possible, the savings and loans, for instance, are no longer; they're now banks. And so we're groping to find what it will take at this point to restore the financial system.

For decades this country has enjoyed great progress in housing. Fifty years ago only 44 percent of Americans were home owners. Half our homes did not have complete indoor plumbing. Less than half our homes had telephones, and more than a third didn't have a refrigerator. By the end of the seventies, two-thirds of us were home owners. During the seventies the housing stock grew by 28 percent, and the houses got bigger and better. Ninety-nine percent had full plumbing, telephones, and three radios. The value of the nation's housing doubled in that decade.

But today, the momentum has stopped and slipped into reverse. Fewer can afford to buy, fewer can afford to rent. We have more homeless people than at any time since the Depression. And I'm old enough to remember—I'm a Depression kid—and it wasn't very pleasant.

Home owners' costs have increased 31 percent since 1982. Renters' costs have gone up by about 34 percent. But during those same years, average hourly wages did not increase at all in real terms. What's more, in some sectors, like retail trade, even nominal earnings are almost unchanged. Last year overall wages increased by about 4.2 percent, but home ownership costs went up by 5.7 percent, and renters' costs went up by 5.3 percent. And that has been the story of this decade. The cost of renting or buying a home year after year has grown faster than the incomes of those who want it and must pay.

Forty years ago the average 30-year-old wage earner could spend 14 percent of the weekly paycheck and buy a house. Today, the average worker has to spend at least 44 percent of income to buy the average home. Today, half of all low-income households are paying more than 50 percent of their income for rent. There are twice as many low-income families as there are affordable housing units. Only 28 percent of those who need some kind of housing assistance actually receive any. A much lower percentage of the poor get housing assistance than food stamps or Medicaid benefits, yet housing is no less essential than food or basic health care.

No less than 13.5 percent of our population is poor, and that percentage has not changed much in this decade. But for Black citizens the poverty

rate is 33 percent and going up. For Hispanics, the poverty rate is 28 percent and unchanging.

During the past 10 years the number of poor people has grown by 11 million. Putting this in terms of housing, the total assisted housing stock—that is public housing, Sections 8, 202, 215, and all the rest—in this country would have been needed just to accommodate the increased number of poor people, let alone reduce the number any. But during the same time, the stock of assisted housing units has hardly changed at all, and during the present administration, commitments to expand assisted housing have decreased by about two-thirds.

Studies indicate that of the 2 million privately owned subsidized units in the country, about one-third are likely to drop out of the inventory within the next decade. The loss of assisted housing stock—if we allow it to take place as it is happening and will undoubtedly continue to happen—will sharply compound the already huge problems of low-income people looking for a place to live. Worse still, the publicly owned housing stock is being systematically neglected, to the point that much of it is threatened. There is a \$20 million repair and modernization backlog. The inevitable conclusion is that the number of homeless people is growing, and about to grow significantly.

What can we do about all of this? First, we need to build on the growing consensus that there must be effective, comprehensive federal housing policies. Housing is not a problem that will solve itself. The increase in percentage of the population that faces impossible housing costs, the phenomenon of doubling up, the dilapidated housing, the dismal surge of homelessness, all of these prove that housing problems can't be wished away, and we can't ignore them.

The National Housing Task Force and the National Low Income Housing Preservation Commission have just recently issued their efforts, and so have about half a dozen other groups. Every one of these commissions ends up with the same recommendation: We've got to reaffirm a national, federal-level commitment to housing. This month's Harvard Business Review did a special report on housing, which shows that even in the most rarified regions, there is renewed support for objective housing policies.

Building on that consensus is a political task. But government professionals like you play a vital role in the process, in fact an indispensable role. It is your job to gather and process the information that is vital to

the development of any effective policies. Only government can adequately define the scope of the need. Only professionals can review and report on what works and what does not. Only dispassionate study can review what is effective and what is wasteful. If we can develop a new housing consensus, it will be largely a result of the work done by professionals like you who gather and evaluate the information on which the whole enterprise depends.

Second, we need to develop programs to carry that consensus into workable policies. Those policies have to address different levels of need. The needs of the homeless are not necessarily the same as the needs of those who need rental assistance. The needs of those who need rental assistance are not the same as those who want to buy their first home. Moreover, at each level of need, a program that works in urban areas will not necessarily work in rural areas. This is important to remember because 44 percent of this country's substandard housing is in rural areas.

In addition to providing for different levels of need and ways that work in rural and urban areas alike, housing policy must have two basic thrusts: preservation of the affordable housing stock that now exists and production of new stock.

And finally, that new housing policy must take into account new financing systems, and what those systems mean for the production and the retention of housing stock. For example, since the advent of rapidly changing interest rates, lenders have devised new mortgages that shift the interest rate risk to the buyers. But when rates rise, many buyers, because incomes haven't kept pace with rising costs, find themselves unable to cope. This may mean a rise in defaults, which in turn may mean rising difficulty in financing homes at all. Any new housing policy must also confront the brave new world of adjustable rate mortgages, or ARMS.

A new national housing policy would have to be at least as ambitious as the one we had in the sixties and seventies. Actually, I should amend that: We need the spirit of reaffirmation that the Depression brought forth.

In 1983, after we had hearings beginning in December of 1982, we began to get the statistics from throughout the country. In Pueblo, Colorado, for example, where the steel mills were closing down, they were beginning to report over 100 foreclosures a month. So I went to the books, looked up the old HOLC, Home Owner's Loan Corporation. We wanted a

program such as the Congress passed when the Treasury was broke, people were broke, millions were unemployed, and the Congress had faith. It provided HOLC to enable those families to keep their homes, and when they closed the program out about 1940 or 1941, it brought money to the Treasury. Nearly \$400 million, and that was a lot of money then. The Congress didn't lose anything.

The Congress never loses when it places faith in the American people. And what is more substantial than that family that wants to keep a home to call its own? I don't know of any other segment of our society that would be more substantial, more dependable. So I introduced the Home Owner's Mortgage Assistance Act, the moment we organized the Congress in 1983. Finally, on May 15 we got it out of the House—on a strictly partisan vote—by less than 20 votes. It went over to the Senate. Of course the Senate for 7 years never bothered to have a hearing on housing, so it languished and it died.

Starting with the homeless, the point of greatest need, this is what I can see. We need to build on the start made by the initial emergency shelters laws, and the McKinney Act, in these ways: expansion of emergency shelter spaces and provision of transitional housing for those who can progress into permanent housing. Transitional housing might also help house the urban migrants who now are reduced to living in public parks for lack of affordable housing. We need to build up mental health programs to provide the support that has never been available for persons released from mental institutions but who need help in order to function—people who don't need hospitalization, but still need help. And we need to reconsider priorities that push mentally ill people out of hospitals and into the streets, people who can't function even with help.

Homelessness has many causes, not the least of which is the lack of affordable housing itself. People are being made homeless because they're priced out of the market, no matter how hard they work. For that reason, any policy that is aimed at helping the homeless must also operate to prevent homelessness in the first place. That means retaining public housing units. It means rehabilitating public housing units. And it means providing new supplies of housing with deep subsidies.

In addressing the housing needs of the poor, I do not believe we should overlook the possibilities of home ownership. In the rural self-help housing program, we have proved that poor people can become home owners. That, given a chance, even the poorest among them maintain good homes, improve their lives, and make the most of their opportunities. If

poor people living in self-help housing have a default rate low enough to warm the cockles of a banker's heart, and they do, clearly we're missing something if we think of low-cost housing as only rental housing.

I think it would be immensely helpful if professionals like you were to look carefully at ways and means to bring home ownership to poor people. Nothing binds people to the community like owning a home. A great many localities are requiring developers to provide a certain percentage of low- to moderate-income housing as the price of getting zoning approval. That helps, but only up to a point. No developer has pockets deep enough to absorb any more than a token part of the need.

For that reason, I think it would be helpful if GAO or some similarly dispassionate body would evaluate the potential and limits of these developer give-back policies. GAO has done two studies on tax-exempt bonds as a tool for helping home buyers. Those studies showed that tax-exempt bonds are not very efficient as a means of delivering housing. Nevertheless, the tax-exempt program has been extended, I think largely because there's nothing else available. But clearly tax policy plays a key role in housing development.

In looking at the likely loss of privately owned, subsidized low-income housing, the National Commission found that about half the expected losses would occur because of mortgage default. Tax policy changes would be a key element in preventing that loss, and the housing task force found that production of low- and moderate-income housing for the future would depend largely on tax policy changes. For that reason, I believe any effective evaluation of housing policy would have to include the consequences of current tax law, and how that law might be changed in order to stimulate the production of affordable housing

For a considerable percentage of the population, home ownership is either not feasible or not desirable, but I believe it is unacceptable for us to have a diminishing percentage of home ownership. I believe the overwhelming majority desires to own a home and is increasingly frustrated by the impossible costs and commissions they must meet. For that reason I have proposed the National Housing Trust Fund to assist first-time buyers. The fund would provide a market buy-down for first-time buyers, whose income is close to the area's median, to apply for a house within the FHA mortgage insurance limit. The buy-down would be repaid on sale of the property, recycled into the trust fund, and reapplied to the program. The idea is to make 30-year fixed-rate mortgages available at 6

percent—mortgages that a great many people now shut out of the market would find feasible.

The need for affordable housing will grow sharply in the next few years. Unfortunately, the pipeline to produce that housing is all but empty. So many of my colleagues and so many others seem to think that housing is something like turning on and off a water faucet. You know that it's a long process. It used to be estimated that, by the time a construction appropriation had been approved, a 5-year period elapsed before construction. And the reason is that housing, and any kind of construction generally, is an intricate process. You just don't turn it off and on. And this is something that's been lost sight of. Now that the pipeline has been exhausted, we're really entering a critical stage, and it won't be easy.

We need to build a new national program to address the need, one that preserves and rehabilitates affordable housing, one that maintains the potential of other stock that can be used for affordable housing, and one that expands production by bringing housing costs within reach.

You and people like you make it possible to derive the needs. You make it possible to determine what works and what does not. You make it possible to determine what might work and what might not work. You are the indispensable element in the process of transforming the emerging consensus into policy, and then into houses and apartments. That is why I appreciate so much this opportunity and I appreciate this seminar overall, and I look forward to seeing the research that will flow from it.

Every human being I know wants a decent home. I have been in the meanest corners of this country, including right here in D.C., which has some of the meanest. I have visited every single public housing unit in the District of Columbia, informally in most cases, sometimes as sort of an official review, but it's been the informal drop-in visits that have been the most meaningful and devastating in their impact. In every one of these places I have met decent people who want nothing more than modest, decent shelter.

In rural communities, where livestock live better than the people who pick your food, people tell me, "We don't want to live like this but we have no choice." Even the poorest have dignity and want respect.

In the midst of squalor, there is still hope. It's a profound thing. For those of us empowered to translate that hope into reality, to do nothing is sinful.

I hope this conference is reflective of a new national consensus to move ahead. The need is there, we know how to do the job, the need is to get on with it.

Remarks of the Panel Moderator, Dr. Anthony Downs, Senior Fellow, Brookings Institution

Dr. Downs: I was asked to briefly summarize what I believe are the nation's major housing problems and issues in 5 to 10 minutes. And with this generous allowance of time from GAO, I'm going to use extreme condensation, brevity, and cite no facts whatsoever.

In brief summary, I regard the nation's housing problems as follows. First, there's a worsening shortage of low-rent housing units that low-income households can afford. Under HUD's definition, any household can afford to spend 30 percent of its income on housing. This used to be 25 percent and in Europe is about 12 to 17 percent, depending on which government you look at. This worsening shortage is one of the causes of homelessness, the second major problem, which the Congressman of course mentioned. Politically, homelessness, because of its high visibility, seems to be shaming the American middle class into supporting larger federal spending on housing in the 1990s. So one of the things those of us who are interested in promoting more federal assistance to housing can hope for is even greater visibility of homelessness, which is a negative or perverse incentive on our part. Obviously I don't wish for more homelessness, but I do think it's going to have this political effect.

The current shortage of low-rent housing is likely to be aggravated by the potential removal from subsidized status of not only privately owned, subsidized units, but also many publicly subsidized units whose program appropriations will expire sometime during the next 2 decades. The preservation of these now subsidized units in subsidized status is the third major housing problem.

One of the things that has been conspicuous by its absence in the reports of various commissions, especially the Housing Task Force, is estimates of the costs of dealing with housing problems. The reason for that is very simple: The cost is huge and nobody wants to talk about it. It's very similar to the invisibility of the federal budget deficit problem in

the present political campaign. No one is willing to discuss it because they don't want to face up to the costs of dealing with it.

In its report, the Low Income Housing Preservation Commission, of which I was a member, did try to face the cost of preserving a mere 645,000 privately subsidized units in subsidized status over the next 15 years, and that cost was approximately \$17 billion. Many more units are in similar jeopardy, so the costs of dealing with just this preservation problem are much larger than that.

Another factor affecting the shortage of low-rent units is the deteriorating quality of many existing public housing units, which the Congressman also mentioned—especially high-rise units and large-scale big-city projects. Both rehabilitating and effectively managing public housing, therefore, is the fourth major housing problem.

Another major housing problem consists of high housing prices that reduce the affordability of home ownership. This problem of high housing prices is not restricted to home ownership; it also influences rental housing. The problem is largest in the 10 major metropolitan areas where median prices of existing single family homes exceeded \$130,000 in the second quarter of 1988. The National Association of Realtors' monthly housing price bulletin showed housing prices for 62 metropolitan areas. The most expensive is in Orange County, California. About 20 percent of the nation's population live in 10 metropolitan areas, and those areas are concentrated on the East Coast in the northeastern corner of the country and on the West Coast in California.

At such high prices, purchasing a first home is difficult, even though I think the home ownership problem for first-time buyers is not as severe as the other problems that I've mentioned. For one thing, the percentage of people who own homes has actually been rising in the United States in the past year rather than falling. Also, one of the reasons why home ownership among young people is so much lower today than it was in the 1970s is that the seventies was a very abnormal period. We had negative real interest rates, and almost anybody could buy a house and probably did. I don't think that was a typical situation. Thus, there were very high home ownership rates, especially among young people. Home ownership in the seventies would naturally be higher than under more normal conditions when real interest rates were positive rather than negative.

Therefore, I don't think the first-time home buyer problem is as severe as the other problems I have mentioned, but it has a very important characteristic. It occurs among the middle class and therefore has a certain political attraction: If aid to first-time home buyers is linked with aid to the poor, some of the aid to the poor might be passed. So it's a much more important problem politically than it is in terms of its actual physical severity.

The second impact of high housing prices, in some areas like Boston, New York, and Hartford, is a weakening of economic growth prospects. For the first time since I've been in the real estate business, which is over 30 years, I think that housing prices have begun to affect the economic growth prospects of certain metropolitan areas.

Until very recently people who had a job opportunity in a metropolitan area just moved there, believing that they could find adequate housing. Today, if you are offered a job in certain metropolitan areas—those 10 that I mentioned that have the very high housing prices—you may refuse to go there because housing's too expensive. That's particularly true in the northeastern part of the country, in Boston, Hartford, Providence, New York, northern New Jersey, and Long Island. Those areas are not growing in population even though they have acute labor shortages. Massachusetts, for example, has net out-migration of population in spite of its very low unemployment rate. So the high price of housing causes out-migration, which weakens economic growth prospects in certain markets. But Texas, which had out-migration last year, grew more than all of New England put together because so many young Texans had babies.

The third impact of high housing prices is that the high-cost housing is located in the suburbs, where the jobs are. So there's an increasing separation in space between low-income city people who are unemployed and jobs in suburban areas. That's another aspect of high housing prices.

All of these housing problems have three basic causes. The first and most important cause is poverty. Millions of households have income so low they can't afford to rent or buy decent quality units without spending more than 30 percent of their income for shelter. This cause can be dealt with effectively only by large-scale federal subsidies for the households concerned, beyond what states and localities can afford.

The Reagan administration, which is the most antihousing federal administration since before George Washington, has said that it is up to state and local governments to finance housing programs. But that ignores the fact that essentially the most serious housing problem is that of affordability among low-income renters. That problem is based on their poverty, and poverty requires redistribution of incomes to eradicate it. Income cannot be greatly redistributed by state and local governments because if they raise taxes, residents will move to some other community nearby that has lower taxes. This is especially true for local governments, but also for state governments, as New York found out. Look what happened in northern New Jersey and southwestern Connecticut because of high taxes in New York.

Only the federal government can tax enough to cause a massive redistribution of income, which is what is necessary to deal with poverty. And that means that any effective program of dealing with housing problems requires large-scale federal housing subsidies. Money is essential, and the \$3 billion mentioned by the Housing Task Force is a drop in the bucket and totally inadequate.

Next to poverty, the second cause of housing problems consists of local government regulations that raise housing costs unnecessarily, far beyond what is required for health and safety. I think this is a particularly critical factor that has not been adequately recognized by the recent analyses of housing problems. If the federal government were to spend the subsidies necessary to overcome the gap between housing costs and incomes of the poor, and local governments were free to continue raising the costs of housing as they have been doing, then the federal spending would be in vain. As fast as the federal government spent money to close that gap, the gap would get larger as local governments raised the cost of housing. Right now there's a tremendous move on across the country, because of traffic congestion, for suburban governments to limit their growth and to adopt antigrowth policies that have the effect of raising the cost of housing.

If we have a federal strategy that spends billions of dollars on housing subsidies, which I think we ought to have, but does not limit the ability of local governments to raise the cost of housing, those billions are going to be wasted. I think that it is absolutely essential that some means of limiting the capacity and the ability of local governments, particularly suburban governments, to raise housing costs be incorporated in any national housing policy. That has never been done. No previous federal government policies have ever been successful at limiting the power of

local governments to raise housing costs, and few current proposals are even looking at this problem. Yet I think it's absolutely essential.

The third cause of higher housing costs and of housing problems is high real interest rates. Interest rates are related to the monetary policy of the country. The Federal Reserve has had to use high real interest rates to compensate for the very large budget deficits. Unless we change our budget deficit policies, which neither candidate appears willing to even discuss, let alone do, then we're still going to have high interest rates. They're not likely to go away.

The last housing problem is the housing finance issue. One of the roles of the Federal Housing Administration, Fannie Mae and Freddie Mac, and the thrift industry is providing mortgage funds. This is all up in the air right now because of the dire condition of the thrift business. There's also a big struggle going on between FHA, Fannie Mae, Freddie Mac, and the thrifts about what their relative roles will be in the future. Of course I can't go into any analysis of this now, but their roles will depend on the policies that are adopted by the federal government in response to the present situation.

That completes my enlightening survey of current major housing problems and issues. Both the analysts and the audience will have plenty of chances to add to or amend this summary as you see fit over the next day and a half.

Departmental Speakers

Remarks of Paul Adams, Inspector General, Department of Housing and Urban Development

Mr. Adams: I'd like to briefly run through some of our planned work and then have some dialogue with you because it would benefit us to hear what your concerns are. I hope to walk away from this session with a better insight, and maybe to translate some of that into our work planning.

We have a very large department and a very small staff, so we have to be very selective about what we do. We try to focus our work on where we can have the most impact. We are presently focusing a substantial portion of our work in the two major program areas in dollars: the Rental Assistance Program and the FHA Mortgage Insurance Programs. At present we're providing rental assistance of about \$9 billion from the Department annually. One of our concerns, then, is to maximize the number of people we help with that \$9 billion.

One of the big things that Tony touched on earlier is the cost of housing. We're quite concerned with the whole area of rental rates. Different HUD programs have different means and methodologies of establishing rental rates, and right now we're taking a comprehensive look at the whole area.

Particularly, there's such a need in the modernization and Section 8 moderate rehabilitation area. We're also concerned about the interrelationship between those areas and some of our other programs, such as the Coinsurance Program—where the lender and the FHA are establishing the rental rates. Our concerns include the methodologies used to establish the rates, and whether these rates truly reflect local conditions.

With regard to the Section 8 moderate rehabilitation program, as well as all the other Section 8 assistance programs, there have been some concerns raised about the Department's allocation process. The reservoir of units has dwindled so small and so few funds are available that the Department will no longer use a fair share process. We are making a considerable review effort at the present time to examine the whole issue area of allocating those Section 8 units.

While we're on the subject of rental assistance, we are also concerned with another very broad area—the tenant eligibility question. I'd like to spend a bit of time with that particular question, because it's a long-

term concern with us. The Department has made some legislative proposals, some of which have been acted upon and some of which are still pending.

Tenant eligibility is a voluntary disclosure program as it's presently constituted. There is no systematic way of verifying the disclosures provided by the tenant. We have been working for an extended period trying to develop some systematic way. The one that we have focused on has been computer matching. However, we've run into some impediments because most states have sunshine laws or other restrictive laws which will not legally permit them to share with us their unemployment insurance data bases, which could be used as a systematic way of verifying income or detecting unreported income. Some states have voluntarily agreed to participate in such a program, and we've been in a learning curve to develop and hone our skills in this area.

At the same time that we have been in that learning curve, we've been working with the Congress to get the legislation we hope will ultimately be passed. This legislation has three components. First, a requirement for a tenant on application for assistance to provide a Social Security number. That's the number one thing. Two other pieces of legislation are still pending. One is legislative authority to access the state unemployment insurance data bases. There is a great deal of concern on the privacy question. We think we've addressed all those concerns. We've dealt with committees, staffers, and other groups. You're probably already aware that some other needs-based assistance programs, such as AFDC and food stamps, already require computer matching and access, so we're not setting a precedent in asking for access to that. Lastly, we want to require a tenant verification consent form that would authorize us or the management agency to go to any previously undisclosed source of income to verify that income.

We already have a conflict arising because there is currently a piece of legislation pending before the Congress which is known as the Computer Security and Privacy Act. This proposal would place many restrictions upon us or anyone else in the computer matching area. At the same time we are trying to be an advocate of one piece of legislation, we're planning another piece of legislation to make it compatible with the Computer Security and Privacy Act, making computer matching difficult.

In addition to using Social Security numbers to identify overpayments, three other data bases are used: the Department of Defense (civilian and military personnel), OPM, and the Postal Service record. Substantial

numbers of people are actually on one of those three rolls. We found some people making \$40,000 to \$50,000 who were receiving housing assistance payments.

Most recently the U.S. Attorney's Office, in a concerted effort with us and the local housing authority, brought indictments against 36 individuals receiving overpayments of up to \$10,000. Future actions by legal and local authorities will be taken. We're trying to publicize reviews and indictments as a deterrent.

We realize though that we cannot, on an ongoing basis, do reviews of tenant eligibility. The universe is too large, so we're going to work with the local agencies and others, as an educational process to try to improve information on tenant eligibility and therefore eliminate the problem up front. Currently we're developing a desk handbook as well as a video tape as an educational process.

The second area of concern is the single-family mortgage insurance program. You heard the Chairman's remarks earlier about the cost of housing. It's a significant problem. We will have a continued emphasis on the problem. Each of you has probably seen local articles concerning some of our work in the past couple of years. By working with the Department, we have either withdrawn the approval of lenders, reached settlement agreements with them for millions of dollars, or required them to enhance their quality control programs. We'll also be looking at the Department's own initiative in monitoring mortgagees to see what we can do to get a better grasp as a Department on the ongoing activities of our lenders and the quality of the mortgages they originate.

Within that process we are very concerned about the appraisals that are being done by and on behalf of the Department. You may have seen some information that came out in The Washington Post about some reports that we did on the disposition of acquired properties. More recently, you might recall an article that said that at the same time the Department is arguing that it has the responsibility to get the maximum return for the FHA insurance fund—and argues against the suit on providing acquired properties for the homeless—we are saying that the Department is not getting the maximum amount for the properties.

We have a considerable interest in housing vouchers. We're going to be devoting a lot of resources on how the local public housing agencies are administering the voucher program, to see if they're achieving their

objectives. One area of particular concern to us is housing quality standards. Something over 40 percent of the units receiving assistance had housing quality standards violations. We have a continued concern about the government providing housing assistance, and safe, sanitary, and decent housing.

We also have a continued concern with the Grants Management Area. We're concerned that, as we move to more local administration of grant programs, we also have sufficient oversight to ensure that those funds are expended for their intended purpose.

And lastly, an area in which we're trying to develop our capability, is the automatic data processing assistance for the Department. We have scheduled, for instance, some work in an area known as the single-family servicing system that services mortgages held by HUD. Also, we have a contractor-operated system in the multifamily accounting, reporting, and servicing system, and we're going to see how that is working.

I'm going to stick by Tony's rule and cut my remarks short because I do wish to have some dialogue with you. I think the kind of questions that you may ask based on your experiences may also provide me some insights that I won't otherwise get.

Remarks of Donald J. Keuch, Jr., Deputy Assistant Secretary for Administration, Department of Housing and Urban Development

Mr. Keuch: I guess as the first non-audit speaker from the Department, I ought to start off by saying that this conference reminds me of a well-known joke that goes like this: There are two big lies in Washington. The first is spoken by the person who comes to another and says, "Hi, I'm from GAO and I'm here to help you." The second is the reply: "I'm happy you're here." I guess that as the day goes on we'll find out whether that's true or not.

As we approach the study period that Representative Gonzalez talked about, we're in a transition period already. Agencies are in the process of transition planning and advice. The major issues that the Department is going to have to deal with very quickly were discussed earlier. One of the first issues will be the budget. Decisions will have to be made very quickly in January, February, and early March with regard to changes that the new administration wants to make in connection with the budget. What these major changes are, obviously, will depend upon which of the two candidates is elected.

We will have already submitted our budget to the Congress for fiscal year 1990. There will have to be some very quick analysis on the part of the new team with regard to that budget. The appropriation hearings, even in an election year, will probably be scheduled as usual in late March, early April, perhaps into early May. The administration will have to get on board very quickly with regard to what the policies are, which ones they want to change.

In addition, the Department will begin preparing the fiscal year 1991 budget estimates. Some guidance and directions will have to be provided for that process from the new team. Whether we're going to have more construction or less construction. What about the homeless? What about all of the other areas that have been issues over the years? In this whole process the thing that will have to be decided quickly will be: Who are the major players that the Secretary must have involved? How many people will be on board to handle these issues in the early days? What will the role of those players be?

Likewise, the Secretary is going to have to look at the management of the Department. Certainly there will be transition planning, and other issues involving the Secretary and Under Secretary, the Assistant Secretaries, and the Regional Administrators.

A whole series of management processes are established and operating within the Department. An example of one of these is the management plan process. The 1989 plan is initiated at the beginning of the year, and will have been in place in fiscal year 1989 for 4 months when the new administration begins. The field structure must be notified very quickly of any changes in the management plan for the current fiscal year.

Another issue is the relationship between political and career staffing developed in the agency. How much trust or how much suspicion, how much team work will be allowed to develop during these early periods? Usually in Washington, both parties come into the relationship with a large distrust, a lot of war stories, a lot of previous experience, whether they're on the outside, or even on the inside, and then we all unconsciously act at fulfilling each other's fantasies. We ultimately cut through the barriers and learn to cooperate with each other. Hopefully, this time we'll do a little better job. I think there's a need for not only orienting the political people, but also orienting the career people so that they recognize that regardless of whether the voters' mandate is a 51 to 49 split, or a 75 to 25 split, the people coming in do have the right to make changes.

In addition, there is and will be a need for program and administrative changes. In my area, administration, what will be the management emphasis of the new administration? Will there be a change in terms of the things that the Reagan administration wanted accomplished? I think the answer to that will obviously be yes. There will be a change regardless of whether Bush or Dukakis gets elected. We will have change in terms of the way in which some of these management issues were identified and were dealt with in the past. How much change there is will depend upon the conditions at the time, the individual that's elected, and the group he is surrounded by.

It's unlikely that any administration is going to be able to make many major program changes and forget about the area of management and administration. In the past, major issues have been dealt with but the actual management and administration was not really focused on in much detail. The deficit problem facing us all now will make it imperative that agencies deal with how well they manage as well as on what they manage.

The Reagan administration, whatever their faults, will get high marks in the sense that they came on board running in terms of what they wanted to do and the changes they wanted to make. The areas of change included cost reductions, productivity and quality improvement; internal control reviews; contracting out versus hiring staff; and other management initiatives to reduce cost and improve service. The fraud, waste, and mismanagement initiative and the delegations of responsibilities by the central staff agencies to program agencies to do a better job of managing their resources, were initiatives that occurred during this administration.

How much of that continues? We'll just have to see. Some may continue, but under a different name, because the new group may want to have its own identity. Nevertheless, the deficit, whether people want to talk about it in an election or not, is going to still be with us. We're going to have to deal with it, and the program needs, and the need for a tax increase or a tax decrease. Cost reductions, quality improvements, and improved service and responsiveness of our activities are things that we have to work on.

Another area that will need early attention by the new team is the implementation of the Fair Housing Amendments. New legislation is going to be signed in just a matter of days, if not today. And 180 days from now will be the start-up of that new program, just after the new

administration comes on board. The implementation plans for this new program will have to be reviewed early by the new administration to make sure that what has been planned is what they feel ought to be done.

Another is a major contract that we're undertaking to consolidate all of our automated data processing activity. The contract is currently out on the street, and within the first year of the new administration it will be awarded. It's a major procurement that will bear review and validation as it moves along.

As you remember, back in 1981 one of the first things that the new administration did was freeze staffing and hiring. Issues of that nature may have to be faced once again.

The single-family and multifamily property management program may be looked at. Distributed shares and one-time premium payments result in a lot of congressional and general public mail and may be seen as an issue for the new administration.

Another area is drug testing. That initiative is a difficult one that is complex and emotional. It's underway but we could very well be in a situation where we're going to have to make some changes in that process. Another area is AIDs in the work place, and the effect that has on the staff within the Department.

Some other possible areas of consideration for this administration will probably not begin before they come on board. We are currently coming to the end of several extensions of a labor management contract for Department employees. A renewal will begin to be negotiated around the first of the year, and may be in process just after they come on board. The new administration's philosophy, their management guidance will be sought. More recently we've had a task force look into the Department's directive system and another look in the Department's evaluation and analysis system. In both cases lengthy reports were prepared and recommendations were made for changes and improvements in these areas particularly in the directive system. One of the problems we need to address is the fact that we have a lot of regulations and handbooks out there, and a number of them are outdated.

In addition, we have a lot of policy that has been issued by memorandum instead of through the official issuance system. We're trying to develop a more orderly process for policy issuances and to capture all of

this unofficial administrative and program guidance that's currently out in the field, so that it can be codified and managers do in fact know what it is that they're supposed to be doing.

Another area is government ethics and the do's and don't's for keeping out of trouble with Congress, GAO, and the media. Areas of concern include the use of government cars, official traveling, and writing books on government time. I must say I have run into more of these abuses in HUD than in any of the other agencies I've worked with during my government career.

With that, I think I'm about at the end of the 17 minutes that was allotted to me. That is just by accident, I assure you, and coincidentally I'm also at the end of my list of issues and matters that the new administration will be faced with once they assume office.

I'm now open to any questions that any of you might have on any of those subjects that I discussed or on any other that I may not have touched on.

Remarks of Kym Couture, Deputy Assistant Secretary for Legislation and Congressional Relations, Department of Housing and Urban Development

Ms. Couture: I am pinch-hitting for Tim Coyle, who is our Assistant Secretary for Legislation and Congressional Relations, and he sends his regrets that he won't be here with us today. As we speak he is at the White House participating in the historic event of the signing by President Reagan of the Fair Housing Amendments Act. This is legislation the President and the Secretary have been working for and struggling to obtain since the beginning of this administration, and I do hope this legislation will remove the last barriers to equal housing opportunities for all.

With me today is Chris Lord, who worked with single-family issues in our office, and he will discuss those issues with you in a moment.

We'd like to give you some insight into some of the major ideas on future housing legislation. At this time, of course, everything is subject to change because proposed new approaches to housing assistance are in the conceptual stages only.

During this year Senator Cranston and the task force—chaired by James Rouse, one of the nation's largest developers, and vice chaired by David Maxwell, the Executive Officer of the Federal Management Mortgage Association—completed a report that is being used as the framework for discussion about housing legislation being passed. Based on that report, the Senate Housing Subcommittee produced concept papers. Although some Members of Congress have introduced bills drawing on parts of the Maxwell report, a broad-based committee bill has not yet been introduced.

Among the proposals contemplated by Senate staff is what would be called the Home Corporation, to be administered by the newest Secretary of HUD. The Home Corporation would provide funds to states and local governments for housing activities, guarantee securities backed by state and local mortgage pools, and provide technical assistance.

Long-term, low-cost capital for assisted housing will be provided through a new program called HOP, which stands for Housing Opportunity Partnerships. HOP is a block grant type program requiring state and local matching funds. The idea is for state and local governments to design an affordable housing system so long as their activities fall within federal guidelines.

Another part of the concept papers includes changing the form of rental subsidies for low-income families by replacing vouchers and Section 8 certificates with what are to be called rental vouchers. Once allocated to localities, rental vouchers can be used for what localities believe to be the appropriate combination of project-based subsidies or tenant-based subsidies, at their option.

HUD management is in the process of carefully reviewing the proposals of others relating to single-family housing, which Chris Lord will discuss with you now.

Remarks of Chris Lord, Office of Assistant Secretary for Legislation and Congressional Relations, Department of Housing and Urban Development

Mr. Lord: Thank you. When we speak of single-family housing, we can say that at the end of last year and the beginning of this year, we actually did see some initiative taken as a result of cooperation between the Congress and the administration, something we don't always see with

respect to single-family programs. We've seen the creation of a permanent authorization for FHA, higher mortgage limits, a step toward terminating Section 235 programs, and changes directed toward reducing fraud and abuse, such as equity skimming. We recommended some suggestions to the Hill and amazingly they accepted them.

With respect to the future, FHA's future depends on some current legal problems being resolved. We have been sued by the Coalition of the Homeless groups. There is currently a temporary restraining order against FHA seiling any of its single-family properties. If that prohibition should continue for any length of time, we face potentially serious funding problems with the FHA fund. Hopefully, this is something that the Congress can address.

With respect to the future of FHA from HUD's perspective, we would like to build upon the record of the last 7-1/2 or 8 years. We have made some changes in the single-family program that have increased home ownership opportunities in general. Also, the changes in the economy have led to improvements in opportunities for home ownership. These are things that we do want to see continue.

At the same time we do want to eliminate some FHA programs that we think have eliminated some home ownership opportunities. For example, the Title X Land Development Program is the type of program not being used to any great degree, and we think should be terminated.

At the same time we also recognize that the Congress is concerned about housing affordability, particularly for first-time home buyers, and I think this is something that is going to be important in the election year. Legislation has been introduced by Senators Heinz and Sasser, and Congressman David Price in the House, that would address specific problems of first-time home buyers. The legislation would reduce down payment requirements for first-time and other home buyers by reducing down payment requirements under the first \$50,000 of a mortgage. It would also more or less make the adjustable rate mortgage program more compatible with adjustable rate mortgage requirements currently available in the private sector.

More and more concern is being expressed about FHA's maximum mortgage ceilings. It may be essential to eliminate the maximum mortgage ceilings in high-cost housing areas.

HUD really has no official position on some of these items. I think, based on past statements made by the Department, that we can anticipate we might have problems with some of the proposals on a couple of grounds. First of all, we are concerned about the solvency in the insurance program—that is one of our primary considerations. There is ample evidence to indicate that the lower the down payment the higher the rate of default, and it's something that we're very much concerned about. There's also the philosophical question of expanding into a conventional mortgage market. We agree that there should be limits on FHA's activity. We should be targeting to certain groups of individuals and letting the conventional market handle what it can.

A couple of additional notes. The issue of micromanagement is something that we certainly see from the Office of Legislation and Congressional Relations. It's very difficult to do anything without some direct guidance from the Congress. There were many evidences in the 1987 act of Congress telling us specifically what we can and can't do with respect to managing our field offices. There is also the matter of the requirement of Section 70 of the Housing and Community Development Act, which requires that all of our regulations, proposed and final, be reviewed by the Congress. This is a catch-22 situation. The Congress tells us specifically what we have to do and we try to do it. We send the regulations to the Hill and the Congress will sit on them and tinker with them for a while. This situation creates a problem for us, and I don't think it's something that is going to end with this administration. The problems existed before this administration ever came in, and they're going to exist for whatever President, whatever Secretary, has to administer these programs.

Panel Members on Public Housing Programs

Remarks of Gordon Cavanaugh, Legislative Counsel to the Council of Large Public Housing Agencies, and Former Administrator of the Farmers Home Administration

Mr. Cavanaugh: Good afternoon, everybody. First, I'd like to do a little reading from scripture. If it hasn't been brought to your attention, you should all take a look at A Decent Place to Live—the report of the National Housing Task Force—you'll see the task force is made up of a variety of people, many of whose interests lie outside the public housing field. I think the report is really worth going through because it represents some opinions that were arrived at after a great deal of debate. I think it's very important that people be aware of the document, as I hope it's going to drive some of the legislation in the upcoming years.

According to A Decent Place to Live, the federal government should, one, support the restoration and revitalization of public housing. Two, HUD must identify and remedy the most seriously troubled projects. Next, the federal government must commit to the complete modernization of the public housing inventory. Then, the federal government, in partnership with state and local governments, must take steps to strengthen the housing authorities and their management. As part of that, the task force recommends that the performance funding system for operating subsidies be revised to reflect more accurately the current needs of the public housing authorities.

HUD and the local authorities should continue efforts to involve tenants in project management. Next, HUD and local authorities should explore carefully situations for home ownership and sales of projects. Next, the federal government should allow public housing authorities to produce housing within budgetary constraints. The last phase was a negotiation with the home builders.

As I look around the room, some of these sessions turn out to be how to lose friends and alienate people, because I'd like to talk about HUD for the moment.

A federal role in government presumes that a federal agency is talented and filled with experience superior to that of those whom it would regulate. Secondly, it presumes that it is organized to do its job. I would say, as I think would others who have seen the Department since its birth in 1965, that it would not be untimely for a very serious review of HUD's management of public housing, to see whether or not it is time to put public housing under a separate federal agency.

The next thing is in the organization of the Department. It's hard for us to understand why the Section 8 certificate and voucher programs are not administered by the Assistant Secretary, who supervises and can influence the decisions of public housing authorities. I think you ought to look at that and see what the reasons were, within the Department, that led to that decision. They may not have been programmatic ones.

Next, year after year, public housing goes through being bludgeoned by the same troubled projects, usually by the same troubled housing authorities. It would seem that a federal department serious about trying to regulate the program could come up with, after these 23 years, some more comprehensive approach of how to deal with what has been a basically repetitive problem. There are 3,300 public housing authorities in this country, most of whom don't have trouble from January 1st to December 31st. Some have some trouble, but there are a half a dozen or so that are perennially a problem, but you'd think as a nation we would somehow solve this.

Next, the gruesome projects. We've obviously consigned people to live in God-awful circumstances. You can see them—in fact, they're the only projects that journalism ever covers. Something ought to happen about that. I must say that the reflection of us as a community is one that's upsetting and disturbing. We plainly are a nation where racism exists, which is a handicap to making progress on this or any other problem that serves those people who happen to make up the poverty population.

One would hope that we'd have a federal government at some stage that would decide what it's going to do on the racial issue, because it's very much part of preserving public housing, expanding public housing, and having a population in public housing that has some reason for aspiration.

Next is the lack of understanding of how public housing operates. There is often a great deal of confusion about it, and some of that is reflected in your own notes of the program. The total operating expenses of public housing are met about 50-50 by rents and the operating subsidies. The operating subsidy is a formula established in public statutes in 1974. The Department took an accounting snapshot of the books of public housing in 1974 and 1975 and of the scope of the housing authority operations at that time. The only thing that has happened to the formula is that we've added an inflation rate based on what was given to us by

the Office of Management and Budget. And if you want to live in a climate where the inflation is never very severe, look at the OMB inflation rates since 1974, you'll love it. You'll be a richer person than you are now. But that is all that system is. It is a system that has been stultified. The Department has refused to open the system to look at the changed cost of operation.

We all know now that, if nothing else, people who never had a guard in public housing in 1974 have virtual police forces at this point. Those police forces came at the expense of maintenance, at the expense of rent collection, at the expense of social services, at the expense of everything that goes on in public housing.

What we all forget is that modernization is the only capital money that public housing has to renovate itself. Nobody has ever questioned the Farmers Home Administration program, the 202 programs, the long-term Section 8 new construction and substantial rehabilitation program, all of which subsidize rents and, by program definition, generate replacement moneys. In other words, we've been subsidizing modernization on an annual basis through Section 8 subsidies, rental assistance, and other subsidies in these other programs. Public housing is standing out there looking, but we have to come up to the Hill every year and say we need a couple billion dollars to modernize.

The most conservative figure that people have for the value of the American public housing stock is \$75 billion. That's the lowest figure I've heard anybody offer, and you divide it by any depreciation term—I would take 25 years, you can fill in your own figure—you will come out to an annual depreciation amount that is in excess of what the annual modernization appropriation has been. The yearly depreciation amount is about three times the amount appropriated annually for modernization for the past few years. So you have to think of modernization and public housing in those terms.

Some of you may remember 4 years ago when Phil Abrams was here, there was an effort to use fair-market rents as a way to calculate the operating subsidies. The public housing authority said, "We would love the fair-market rates, if you will subsidize us between the statutory rent that we can charge to our tenants and the existing fair-market rents in our areas, we'll make that deal tomorrow morning." HUD and OMB backed off.

I think we need a serious General Accounting Office review to focus on the performance funding system. Does it reflect in 1988 the scope of operation and cost of operation of public housing? Secondly, we need to recognize that public housing tenants have changed dramatically. I was reading the St. Petersburg Florida annual report the other day and, where 10 to 15 years ago they had virtually 100 percent male-headed households, now they have virtually 100 percent female-headed households—one parent in the household with children. Everybody I know throughout the large public housing authority is perfectly happy to house such families. There is no problem with the families as families, but we would like somebody to recognize that single-parent households do present additional costs in operations in ways that those of you who have children would recognize.

The cost-beyond-control provisions in the performance funding system have never been implemented by the Department except once in 1981 when the HUD Assistant Secretary called up people and went out with the money overnight, and kind of slammed the door on it ever since. But housing authorities regularly during the course of their year run into significant increases in cost that cannot be projected in the budget. They have to swallow them. And of course what they swallow themselves into is the deterioration that you see in some housing authorities.

And somebody has to deal with our population. I'd like to suggest, or at least refer you to the fact, that a more diverse income mix would be appropriate. I think all anybody has asked for is to go back to 1981, where 25 percent of tenants could be within 80 percent of median income.

I had the opportunity to run the Farmers Home Administration, whose income eligibility criteria is broader than the public housing income level criteria. Even in these past 8 years, while Farmers Home was at lower program levels, it has never been jeopardized in the way the public housing program has. A lot of that is just telling Americans that we like people who are slightly above the poor, and I think we ought to think very seriously about our message.

I want to move to modernization. Another thing that's been exasperating to us in public housing is that 4 or 5 years ago we went to Congress and they said, "Why do you come up here every year asking for money for modernization? When does it end?" We said, "Spend \$4.5 million through HUD to measure what is needed." That study was done. It's a

very, very valuable public document for which you and I spent considerable amounts of money, and it was done in a very reliable way.

HUD has, in my view, and I think the view of everybody in public housing that is associated with this, been trying to adulterate that document in a variety of ways by eliminating whole parts of what needs to be modernized in public housing. Basically the document said that we had a variety of figures, but the figure that everybody lands on is that about \$18.5 billion is needed to modernize public housing, to bring all units up to what would be current standards of livability. And obviously, we're at a current appropriation level of \$1.6 billion to \$1.7 billion, and now we've got to step up in the foreseeable future to reach a much greater figure.

There are subsets to that study—none of which have been made available. The subsets are: Where are those problems? What are the family projects? What are in the high rise projects? Where are the elderly projects? What parts of the country are they in? What are the costs per unit? What is the range of those costs per unit? For example, it has been found that 26 percent of the public housing that needs to be modernized could be done for about \$5,000 or less per unit.

All I'm going to say is that the Department, in my view, is denying the rest of us the bare facts of the study, and the analyses that it produces that could meet public policy. If the Department wants to debate the facts, then that's fine. That's good public policy debate. They may win, we may win, but at least the debate ought to be on the facts, and they should be required to release the report.

The next issue I think you need to face in modernization is that the Department has proposed, over the past 3 years, a comprehensive grant program. You'll find it very difficult in these 10 floors to get anybody to specify exactly what that program is, because they've never specified it except to say that they would come up with a formula, and the formula would drive modernization money into the 3,300 housing authorities, regardless of need.

Next, I think, is something that goes back to this whole issue of trying to put the American public housing stock in a form that none of us as citizens has to apologize for. You've been in these projects. You wouldn't want to go home and explain to your children why other human beings are having to live in some of these situations. We lobbied, I guess 3 years

ago, for the dual use of the development money for either new developments or the major reconstruction of what got to be known as "obsolete" projects, so that a 40-year old project is brought up to date and you've got another 25 to 40 years in it. A critical question is: What has HUD accomplished with these funds?

I think you have to look at the experience in the Section 8 voucher versus certificate program. The Cranston and D'Amato effort is trying to meld those two programs into something in common, and undoubtedly GAO will be asked for its views on that. You need to examine the literature on it very carefully.

Somehow, as Americans, we've got to find a way to get ourselves out of this horrible budget constraint in which we have allowed ourselves to be trapped. This administration is going to get up and walk away from the bar on January 20th, and they're going to leave a check on the table that the rest of us are going to choke on for a long time.

Thank you.

Remarks of Dr. Michael Stegman, Professor and Chairman, Department of City and Regional Planning, University of North Carolina

Dr. Stegman: Thank you. My comments will touch on nine issues, the first five in more depth than the final four. And the order in which I'll discuss the issues are the resumption of production of public housing; social services and public housing; management; home ownership under HUD's national public housing home ownership demonstration and the 1987 Housing Act; the reimposition of ceiling rents; public housing waiting lists; tenant assignment policies; the effects of income mix on the quality of life; and drug-related crime and violence in public housing.

First, resuming production. Overall, government studies have shown public housing to be a relatively cost-effective form of low-income housing, which enjoys a great cost advantage over other forms of subsidized development because the buildings remain in public ownership after they're paid off at the end of 40 years.

Although my review of the existing cost-effectiveness studies took place before publication of the report of the National Low Income Housing Preservation Commission, the findings of that body regarding the cost of preserving this threatened stock I think underscore my position. According to the commission, it would cost approximately \$18 billion, or more

than \$26,000 per unit, to preserve the 645,000 privately owned and federally subsidized low- and moderate-income units built between 1961 and 1973 that are at imminent risk of loss due to expiring use restrictions and/or their federal subsidy contracts.

Based upon public housing's relative cost-effectiveness, growing waiting lists, and the permanence of public housing as a low-income housing resource, I indicated that the Congress should resume production of public housing at an annual volume of 20,000 units. Half of these new units would be reserved each year as replacement housing for families now living in the most seriously troubled high-rise developments that must be radically altered, reconfigured or demolished. About 3,000 units a year are also needed to offset annual losses to the inventory, and the remaining 5,000 to 7,000 units should be made available through a competitive process of hundreds of PHAS across the country in communities with documented housing shortages and proven development capacities. At an average cost of \$68,900 a unit in 1988 dollars, the annual cost of reviving the public housing production program in the volume of 20,000 units would be about \$1.4 billion.

I emphasized in my paper that a resumption of production does not necessarily mean public housing development business as usual. Housing authorities should be given maximum latitude in determining the form that their new production will take. They should be free to use production funds to redevelop old and marketable projects and to acquire existing units in the private market.

I might mention one other important difference between public housing and the inventory of privately owned subsidized projects—and that is that we know where all public housing projects are located. We know who is responsible for managing them. We know who is responsible for administering the programs under which they were constructed. This is more than we can say about the privately owned federally subsidized stock. Save for the National Preservation Commission's recent groundbreaking work, which is based on a field sample of some 300 representative projects nationwide, neither HUD, the Congress, nor any other public entity knows very much about this critical low-income housing stock. The most striking among the commission's findings is that preservation strategies and work-outs must be developed on a labor-intensive, case-by-case, project-by-project basis, because there are no available institutional means of reaching project sponsors on a large-scale, cost-effective basis.

A second issue is the integration of social services in public housing. The public housing issue paper provided by GAO raises the question of whether, "The primary future goal of residents for public housing will be the provision of decent and safe housing as they work toward economic self-sufficiency, rather than all too often what has been continued welfare dependency."

Clearly the answer to the question is yes, but how should we proceed to achieve this crucial goal? One promising possibility is to aggressively implement section 126 of the 1987 Housing Redevelopment Act. This directs the HUD Secretary to "Carry on a program to demonstrate the effectiveness of providing a comprehensive program of services to public housing residents to ensure the successful transition of such residents to private housing over a period not to exceed 7 years." Demonstration programs would have two phases: a remediation phase lasting 2 years and a transition phase lasting no more than 5 years. During the first phase, the housing authority would be required to provide participating families a wide range of services, including remedial education, high school equivalency training, job training and preparation, substance abuse treatment and counseling, and training in homemaking skills, parenting, money management, and so forth.

During phase two of the demonstration, the household head would be required to have full-time employment. While public housing rents are not permitted to be increased due to any increase of earned income during phase one, rents would be permitted to be increased with earned income during the 5-year transition phase of the demonstration.

Section 126 further encourages housing authorities to establish escrow savings accounts for participants that would facilitate their accumulating sufficient funds for a down payment on a private house by the end of the demonstration.

Moreover, in order to encourage public housing tenants to maximize their work efforts, the law prohibits other federal agencies from considering income increases due to employment as income in determining eligibility for various federal benefits during the course of the full demonstration. In other words, the work disincentive effects associated with public benefit programs would be eliminated during the transitional demonstration.

The 1987 act directs the Secretary to carry out the transition demonstration in Charlotte, North Carolina, whose public housing authority

had already begun its own locally designed project prior to the passage of the 1987 act. The law permits, however, but does not direct the Secretary to support innovative variations of the Charlotte approach in up to 10 additional housing authorities. To my knowledge, HUD has made no effort to expand the Charlotte test to the 10 other housing authorities permitted under law, which is certainly not consistent with priority needs.

Emotionally and ideologically I want to believe that tenant management could cause significant economic and social benefits, such as reducing the costs of operating public housing, reducing vandalism, and increasing the stake residents have in their houses. I clearly do believe that to be true, particularly in Kennilworth Parkside, and in a few other tenant management corporations that have survived and indeed prospered over the past 10 years. However, not all tenant management experiments have succeeded. HUD's own national evaluation of tenant management, for example, concluded in 1980 that:

"In most of the public housing developments in the demonstration, tenant management worked just as well as previous management by housing authorities. This suggests that tenants can manage public housing projects effectively under certain conditions, and are capable in many projects. This also indicates that at least in the short run tenant management does not usually produce results markedly superior to those stemming from conventional housing authority management."

Among its other findings, the evaluation also indicted that while tenant management

"Generates additional employment opportunities and social benefits such as a sense of personal development among participants, it also incurs significant additional costs, adding from 13 percent to 62 percent what continued traditional management would have cost in the tenant managed projects."

Although I'm sympathetic to the goals of tenant management, if HUD truly believes that tenant management is more cost-effective than conventional management and will save substantial money over the long term, then the Department should seek substantial funding for this program as an investment that will return major dividends in the future.

In addition to full-scale tenant management, the Department ought to promote a wide range of alternative management initiatives involving tenant participation, including the contracting out of management responsibilities for private entities, and the oversight of management

councils. Management systems operated by PHAs that have maximized tenant employment opportunities should also be encouraged.

The decade of the 1990s should usher in a period of intense experimentation with public housing management initiatives, not the least of which should aim to improve the efficiency and responsiveness of traditional public housing authority management to tenant needs, as well as to rationalize and streamline HUD regulations that now encourage some of those same inefficiencies that tenant management initiatives are designed to overcome.

In the 36-month contract from HUD which I direct, the Department of City Regional Planning at the University of North Carolina is evaluating public housing home ownership demonstrations which began in late 1985. Under this effort HUD initially authorized the sale of up to 2,000 public housing units to individual families.

Since we are in the process of preparing a major status report for the Assistant Secretary for Policy Development and Research, which has not yet reviewed our initial report on the demonstration, I am reluctant to summarize our major findings in today's meeting. Suffice it to say, however, that for a wide variety of reasons, including problems having to do with securing permanent financing, internal disorganization at the housing authority level, conflict over goals of the PHA and how the home ownership program serves them, and the fact that HUD made no commitment to replace the low-rent public housing stock that was to be sold, preparing low-income families to become home owners is more labor-intensive than some PHAs initially anticipated, especially with respect to the conversion of multifamily projects into co-ops and condominiums. HUD also provided little in the way of financial support for the housing authority staff to design and administer its home ownership demonstration. For these reasons, sales during the 36-month demonstration will probably not exceed one-quarter of the number initially authorized by HUD.

And now I'd like to turn to home ownership. As many of you at today's meeting are aware, section 123 of the 1987 Housing and Urban Development Act also authorizes the sale of public housing units. Unlike the public housing home ownership demonstration, however, under which housing authorities are authorized to sell individual units directly to eligible families, section 123 requires HUD to sell multifamily buildings or groups of buildings to qualified resident management councils that have

demonstrated "their ability to manage public housing effectively and efficiently for a period of not less than 3 years."

The resident management councils may in turn resell individual units to existing tenants. Thus, under the Housing and Urban Development Act, the transition to individual unit ownership for a low-income family occurs in three stages. First, the elected resident management council must assume major management responsibility for the project. Second, the council must acquire the project from HUD. This stage, the maximum life of which is not specified in the law, simply changes a tenant's landlord, but does not change the tenant's tenure from being a renter to being an owner. The sale of individual units to tenants occurs in the final phase of ownership transfer under the 1987 act.

As is also true under the home ownership demonstration, sale of a project to a resident management council will result in the termination of HUD's operating subsidies. HUD will, however, continue to pay annual contributions to retire the project's original capital debt, as is currently the case in home ownership demonstration.

There are other significant differences between the home ownership demonstration and the act. They include the requirement under section 123 that all units sold be replaced on a one-to-one basis—which is not part of HUD's home ownership demonstration. More importantly perhaps, it should be noted that the criteria for home ownership under section 123 are much more stringent than they are under the home ownership demonstration.

The fact that 3 years of successful tenant management is required before a project can be sold is very restrictive. Few middle- and upper-income housing cooperatives in the United States are self-managed. If this is so, then why should the creation of public housing cooperatives require a lengthy trial of successful self-management? The necessity of tenant management combined with a 3-year sunset provision and other limitations suggests that section 123 of the act was written to apply to two or three existing tenant management corporations already in existence which would now be permitted to buy their buildings, but it was never intended to have broad national application.

Quickly, the additional issues that GAO should be prepared to consider in the next couple of years. The 1987 act reinstitutes ceiling rents in section 102 of the act. By reimposing ceiling rents and lowering the rent of higher income families, it is likely that the incentive for higher income

families to want to become home owners will change. Part of the incentive for home ownership has to do with the fact that under certain financing schemes associated with the sale of units, public housing tenants can actually save money by owning their housing. This will probably change if public housing authorities reinstate ceiling rents.

Also, the language of section 102 reinstituting ceiling rents contains the concept of economic rent. Economic rents are defined as the average operating and maintenance cost or the average debt service associated with a given unit of bedroom—two-bedroom, three-bedroom, four-bedroom, and so on. It is not clear how HUD is going to write the regulations dealing with economic rents.

If housing authorities are able to adopt ceiling or economic rent programs that vary by building or by location, such changes represent a dramatic departure from the kinds of rent structures that we've had historically. The law says nothing about that. And it's unclear to me, since I haven't seen the draft of regulations, how it's going to be written. There are some interesting possibilities and some financial implications for the operation of housing authorities built into section 102.

Another issue is tenant-designed assignments and practices as these relate to the extent of racial segregation in public housing. I think GAO and HUD are going to have to obviously pay a lot of attention to this over the next couple of years. We know the litigation and so on, but in my travels, some housing authorities I've talked to continue to have their own project-level, areawide waiting lists that are not centralized waiting lists, and not in full compliance with what I understand to be the single citywide or countywide waiting list requirement under HUD rules. Some people have indicated to me that if all housing authorities are brought into compliance with this requirement, it will have substantial implications for the size of waiting lists as families drop off waiting lists because they virtually all are unwilling to move into certain projects in certain locations. All I'm saying is that this is an issue that I have seen discussed. And I think that we know so little about this that it's going to have to be looked at.

The next issue is the effect of income mix on the quality of life in public housing. This targeting debate continues unabated. Housing authorities want to go back and have a greater percentage, of between 50 and 80 percent of median income tenants, go back and embrace the broad income mix rule. We are tending toward increased parity. I don't know what the future holds, but the arguments that the housing authorities

are making are both financial and social. PHAS adamantly take the position that you can't have these large concentrations of very poor families and maintain decent quality of life in public housing communities.

Question. Is it management? Is it the role of tenants? Is it the income mix that really is the key variable in determining quality of life in public housing? These are research questions, very complicated questions, but surely it is an issue that must be dealt with over the next couple of years.

And finally, despite high interest in doing something about the crime and drug play in central-city high-rise projects, it seems to me that we're still underestimating the staggering consequences of this problem. Before we will be able to see any light at the end of the tunnel, drug- and crime-induced destruction of public housing will exact an extraordinary physical cost in terms of increases in permanently abandoned projects, additional personnel, and greatly enhanced investments in substance abuse counseling and education, in addition to the full benefit of social services that we ought to be discussing.

Left to their own devices, locals are experimenting with creative ways of evicting drug traffic while not violating the principle of due process of law. These efforts should be monitored and assessed for their effectiveness and successful development. Several bills have been introduced into Congress that purport to address the drug problem. Obviously there will be serious review. I don't have a position on them. I don't know what the contents are. I do know in my travels around the country, the extent of the problem is much greater than I was aware of.

Panel Members on Rental Assistance Programs

Remarks of Cushing Dolbeare, Consultant on Housing Policy and Programs

Ms. Dolbeare: I want to try to very quickly go through some background information that I think is relevant to the discussion of the issues. I'm sure I'm not going to mention anything that some of you don't already know, but I hope that it will provide a bit of context for the later discussion and comments.

First, starting in 1970, I looked in HUD's annual housing survey at how many households, renter households, had incomes below \$5,000. Thirty percent of that figure is \$125 per month or less. Next, how many households had incomes between \$5,000 and \$10,000, and how many rental units were between \$125 and \$250 a month. These, by the way, are in constant dollars.

About 43 percent of all renter households have incomes that fall below the HUD definition of 50 percent of median, and another 20 percent or so have incomes between 50 and 80 percent of median, so that in fact only about 40 percent of all renter households—these figures may have changed somewhat since 1983, but not a whole lot, I think—have incomes above 80 percent of median.

In 1970 we had more units than households in both categories. By 1983 we had a deficit. We had 2 million more households with incomes below \$5,000 than we had units. Projecting this in a straight line, by 1987 we had a deficit of about 3 million units; by 1995 the deficit would be over 5 million units. Now this projection ignores things like housing availability, housing quality, and the lowest income people living in the least expensive units, and so forth. To me it's sort of a minimalist definition of the low-income housing problem. We still have a large deficit that is caused by two factors: the increase in the number of households, and the decrease, primarily in the private sector, in the number of units.

So programs that are aimed at targeting middle-income families in the rental housing market at median or above median income miss the real need. We're talking about a very small group of people in comparison with people with incomes below 50 percent of median. That is the traditional target of public housing and Section 8—between 50 and 80 percent of median.

With all the talk about the Reagan administration and what it's done to housing, surprisingly since 1980 we have close to doubled the stock of

occupied subsidized housing units. Now, a lot of these units were in the pipeline before 1980, but beginning in 1940, it took 30 years to get one million occupied units. By 1980, there were 2 million occupied units. Now in 1988, there are 4.5 million occupied units. Many of the units have received HUD subsidies. To me, the critical point is that the significant increase in the housing affordability problem that I described earlier occurred at the same time that we were doubling the stock of subsidized housing.

Only a relatively small proportion of low-income families are actually living in subsidized housing; that point has been made before today. However, a much larger proportion of units renting for under \$100 a month are subsidized. These are, again, 1983 figures. Something like two-thirds or three-fourths of the units renting for less than \$100 a month were subsidized units. One would expect that, if we lose these subsidized housing units from inventories, basically there is going to be very little left for very low-income people.

Let me turn now from that rather quick overview to the broad dimensions of what I see as the housing problems, which goes back to Tony's first point this morning, the low-income housing problem, the housing problem which is primarily a poverty problem. Let's look at federal spending for housing since 1981. There are three categories of housing expenditures, and they're all different. The first is new budget authority available for expanding the stock of subsidized housing or vouchered people receiving housing assistance. That's the cost over the life of the subsidy, whether it's 5 years, 15 years, 25 years, or whatever. Federal spending for housing as a percent of total budget authority dropped from 6.5 percent in 1977 to 0.9 percent in 1987. If you use the Office of Management and Budget projection through 1990, it'll be 0.7 percent.

The second item is spending patterns. "Outlays" is a percent of total federal outlays. Actually, it wasn't until 1981 that outlays for housing assistance ever reached the level of 1 percent of total federal outlays. Since then, with the exception of a blip in 1985, which was the refinancing of public housing and did not result in any additional units, it's been between 1 and 1-1/2 percent of the total federal budget. You could add a great deal to housing expenditures and still not affect the percentage of federal outlays for housing very significantly.

I want to call your attention to the following table.

Table 5.1: Comparison of Housing Outlays to Tax Expenditures

Billions of dollars		
Fiscal years	Housing outlays	Tax expenditures
1980	\$5.6	\$26.5
1981	7.8	33.3
1982	8.7	36.6
1983	10.0	35.4
1984	11.3	37.9
1985	25.3	40.6
1986	12.4	48.5
Total	81.1	

Note 1: Housing outlays represent federal spending for housing payments plus operating subsidies.

Note 2: Tax expenditures represent deductions for mortgage interest, property taxes, and capital gains exclusion on the sale of a single-family house.

Housing-related tax expenditures have gone up each year, from \$26.5 billion in fiscal year 1980 to \$48.5 billion in fiscal year 1986. They totaled \$89.1 billion for fiscal years 1985 and 1986, about \$8 billion more than housing outlays totaled from fiscal years 1980 through 1986. Housing-related tax expenditures have gone up even since the enactment of the so-called 1986 tax reform. The focus of attention has been on investor deductions, which are about 10 percent of all housing-related deductions. These are the deductions that GAO analyzed when it analyzed the impact of mortgage revenue bonds. These are the deductions that the tax-writing committees have focused on in dealing with depreciation and so forth. But the real biggies haven't been touched: the capital gains exclusions and exemptions on the sale of single-family houses; the property tax deduction; and the most significant one, the deduction for mortgage interest. So if you want to take a look at where we're spending money on housing, you need to look at those tax expenditures, particularly the mortgage interest deduction.

It seems to me that it's more important for GAO and others to address the broader policy issues of housing subsidies and tax incentives than to address the nuts and bolts of HUD programs, particularly since HUD programs and other programs are now in a period of transition. And it seems to me the most important questions to be looked at are, what are our real housing needs and how can we best meet them.

There is the continuing discussion of do we need production or should we focus on tenant-based subsidies. Now, I'm not sure that isn't grossly oversimplified, and I'd like to suggest that we take a look at redefining

what we mean by "production," and use the word to mean adding to the supply of affordable housing. It doesn't have to be by construction alone, or even by substantial rehabilitation. I think there is and should be a growing role for the acquisition of existing privately owned housing by nonprofit organizations, by public housing authorities, or by other entities which will permit it to remain forever, if possible—or as close to forever as we can come—operated for low-income people, and as a part of a low-income housing supply.

I think the question really is the balance between a supply side approach—which advocates adding to the supply of affordable housing primarily in areas where the supply is barely adequate and needs improvement—and a voucher system.

And the other thing is that what you do depends on the scale of what you're going at. I've been advocating, as some of you know, an entitlement system of housing allowances or housing vouchers for a good many years. I still think we're not going to solve the low-income housing problem without it. But if what we're talking about is, as the Rouse Commission suggested, an additional \$3 billion of investment in low-income housing, it doesn't make any sense to use that for vouchers, unless you're going to use vouchers tied to some kind of transitional housing assistance or crisis intervention or whatever. But to take an arbitrary 100,000 households out of 7-1/2 to 10 million eligible households who need housing assistance and say, "We're going to solve your problem for 5 years and we're probably going to review your vouchers after that," seems to me to be not a terribly valid way of going about providing housing assistance.

I think we should be paying attention, not just to the preservation of the existing stock of subsidized housing, but also—and I think numerically far more important—the preservation of the existing unsubsidized stock of housing that is still affordable. That housing, by the way, is not typically in the hands of people who are developing and building apartments. Most of it is smaller units or single-family units or houses that have been converted into several apartments. It's in scattered ownership. But it's something that I think we need to pay attention to.

In the first place, if the cost of providing housing—just the basic cost of the energy and the taxes and the maintenance and the amortization of the debt, if there is debt on acquisition—is twice what the low-income family can afford to pay, rent control isn't going to do any good. Rent control it seems to me, if there is a role for it, is not a way of providing

housing that's affordable for low-income people, but a way of enabling renters with incomes at or above the median, perhaps, to have some security of tenure in their units and see that their units aren't going to be converted into luxury apartments.

I think it would be useful to have some objective analysis of the major home owner deductions, and the extent to which they are necessary—and by the way I am convinced that they are necessary for middle-income home owners. But we need to analyze the extent to which they are necessary to make home ownership feasible and the extent to which they represent a complete drain on the Treasury in the sense that home owners are mortgaging their houses, affluent home owners are mortgaging their houses in order to invest their money elsewhere because they can deduct the mortgage interest. I think the question of who benefits from these deductions is a fairly significant one that ought to be looked at in the context of housing policy. Only about 40 percent of all home owners actually take any home owner deductions. I suspect the remaining 60 percent are primarily not low-income households, I mean they probably are not elderly households who paid off their mortgages, they're not the people we see as being in housing need, with the exception of a relatively small group of upwardly mobile younger home buyers.

I think we need to analyze carefully the question of what we mean when we say, "affordability," which I've said fairly flippily here a number of times. The 30 percent of income standard really doesn't make a whole lot of sense. It's more a convenience than anything else. Rather, you could use something called a "market basket approach," which is one way of saying, let's look at people's living expenses, their incomes, and how much they have to spend on other things like food and clothing and transportation, and so forth. What they have left is what they can afford for shelter. That approach might be a more sensible way of doing it. If we did it that way and if we used the Bureau of Labor Statistics standard for a modest but adequate living level, we would find that something like 10 percent of all households in this country couldn't afford to pay anything for shelter.

I think we need to look at how we should define income, how we should define affordability, and the final thing I want to deal with is the question of local flexibility. We seem to be moving toward block grants in housing. I think that's a positive move, but I think that we need to look at what kinds of standards and rules apply to those block grants. Particularly, there ought to be very tight targeting standards, and I don't

think we should confuse the tight targeting of housing subsidies with a call for only subsidized projects or only subsidized developments. I think it's possible to have developments in which a small proportion of the units are subsidized.

I think in terms of GAO's future work, it would be important to try to look at the ways in which state and local governments have used the funds which have already been made available to them, and what kind of monitoring procedure ought to be put into place so that, if we have a major federal investment through state and local governments in dealing with low-income or other housing problems, we have some assurance that we're setting the right kinds of standard and doing the right kind of monitoring.

Remarks of Michael Hanratty, Executive Director, Fort Worth Housing Authority

Mr. Hanratty: It's tough to follow everything that's been going on here, so I probably will not be saying a whole lot new, but I will be approaching it maybe from a little different perspective. I'm a practitioner, and my colleagues and I live with the results of federal policies. We live in an atmosphere probably no less politically charged than that within the Beltway. We catch more than our fair share of blame for failed policies or poor legislation, and we've got some thoughts on how to improve the system.

I'll just touch quickly on several issues that were raised in the briefing papers. Are rehabilitation programs successful and cost-effective? The question that immediately comes to my mind is, successful for whom? Successful for the developer, successful for the city, or successful for the lower income families who could benefit from rental rehabilitation? And one of the things that might be tested is the measurement of the displacement of low-income renters before rehabilitation. We could test the number of lower income or very low-income families living in rental rehabilitation or properties after 12 to 24 months to see if, in fact, rehabilitation has been utilized as a way of gentrifying an area, rather than providing continuing very low-income housing.

Another option might be to look at the relative efficiency of loans versus grants, since city governments tend to do their rehabilitation in numerous ways. It might well be a good process to take a look at which one is the more efficient use of capital, and at how those funds are monitored at the local level.

First, for Section 8 moderate rehabilitation program, given the recent publicity, it might be in order to examine the entire system by which HUD allocates those units. There was an article in the July edition of Multi-Housing News about a pattern of distribution of units which, if the allegations are correct, makes a sham of a system that purports to be equitable. As a matter of fact, I would even suggest that the allocations system be examined as it applies to the allocation of all units, be they public housing, Section 8 certificates, or housing vouchers. You might want to look at the role that fair share plays, or at whether HAPS are utilized in any equitable system of distribution. HAPS, for those of you who don't know, is a Housing Assistance Plan that's produced by a city as part of its community development block grant program. It is the city's analysis of need for housing. I guess the question that always comes to my mind is whether it's another report that gets filed on the shelf and is not used other than to justify something down the road.

A second issue that was raised is rent control, and quite frankly I am singularly unqualified to speak to that. Texas is not one of those states that would even endure—I was once called a socialist for advocating a limited equity co-op. So rent control is clearly out of the question from my knowledge and perspective.

I think Cushing talked very directly to the third issue of prioritization and direction and allocation of housing, federal housing assistance, and the issue of production versus subsidy in place. What is the best kind of a mix given the limited resources that we have?

The fourth question was how much flexibility might local government have, and I think this is where as a housing system we have some great opportunities. Presently, the system doesn't allow for much flexibility. And I'll speak from the PHA's perspective. There's a different set of strings and restrictions for every program out on the market. We need really a new strategy nationally that allows us to make determinations that are best for our communities.

I would suggest that we ought to allow targeting to low- and very low-income, not just to very low-income; allow complete local discretion in establishing payment standards; and retain housing quality standards. And I really need to comment a little bit on Paul Adams's discussion of the 40 percent number of units that fall outside of housing quality standards.

I'm not sure I'd debate that. I think it's very possible that on any given day, 40 percent of the units might well fail the housing quality standard test. The question is responsibility, and where does the PHA or the person who is administering the housing quality standards fit into that equation. Is the housing authority responsible daily? What responsibility is there when the certificate or voucher holder creates the damage? Obviously it's not going to be reported to the housing agency, and the tenant's not going to report it to the landlord. Somebody comes in, finds a violation of housing quality standards, and a broad, rash generalization is made that 40 percent of the units are outside of housing quality standards. That doesn't explain away the fact that some of the agencies that are in the Section 8 business do a lousy job of it. I can't explain it either, but I think you have to really look at the underlying circumstances.

There was an issue several years back where a housing authority in the state of Texas had abated rent on a landlord and said that it was the landlord's responsibility to have checked the unit—either the gas or electricity were cut off. And the landlord appealed to HUD, and my recollection is that HUD replied that the housing authority really should not expect the landlord to be checking his property every week, or every 2 weeks. There's a standard of reasonableness that maybe should be monthly or bimonthly.

And again, if you're absolving the landlord from that responsibility and then trying to hang the housing authority for failure to meet housing quality standards, I think there are some issues to be looked at.

I also think that in terms of rental assistance, we ought to have the capacity to target units, whether it's a 20 percent target or 40 percent target. Right now we can't target. There is some possibility, if we could target assistance, that we could make deals work now to rehabilitate or to integrate—economic integration of developments—that can't be done now.

The fifth issue that was raised is federal interaction with states and nonprofits. I think the federal government can learn a lot from the states. If you consider Massachusetts, Maryland, California, where there are successful state programs and successful nonprofit programs, I think we may be able to learn something that we can fold into our national discussion. The key more than likely is that they're dealing with local problems, not national problems. When we define a program

of national scope and try to put on stringent kinds of national restrictions on it, we lose the capacity for innovation at the local level.

I was going to talk a little bit about the Rouse report. It's been mentioned a couple of times. I think it's important for you folks in the housing end of this to be familiar with the report because it is in fact the jumping off point for the Senate's consideration of housing policies that will be coming up in 1989. As was referred to earlier, there is now a working paper that talks about folding of Section 8 vouchers and Section 8 certificates into a "rental credit" kind of process.

I found many things missing from the Rouse report. Among other things is a role for the local PHA. We can sit here all day and debate the relative expertise of PHAs. In fact, you have a level of expertise that ought to be at least engaged in the discussion of where the housing policy of the country goes.

There are some issues I would raise to you maybe for consideration, apart from the issues that were raised in the briefing papers. One has to do with the utilization of housing vouchers. If you're familiar with housing vouchers, you know that the PHA gets an allocation in dollars. Those dollars are based upon a typical two-bedroom unit, and by application of a formula you are supposed to generate X number of housing vouchers from those dollars. It doesn't work in the real world. About 70 or maybe 80 percent of our allocation is being translated into units, not because of any inefficiencies of ours, but because of a formula that credits a family's rent at a level not based upon real world data in the local area. So I think if we're claiming to do 5,000 housing vouchers, it would be interesting to see what we really translate that into in terms of units.

The second issue has to do with expiring contracts. We can talk all day about the 3-1/2 million low-income housing units that are covered by these contracts and, therefore, could conceivably be lost in the next 15 or 20 years. There's an issue that's of concern to the folks at the housing authorities as well—that Section 8 existing certificates that were placed into service back in 1975 will start expiring in 1990. If they are replaced by housing vouchers—and we talked about the dollar allocation system rather than the unit allocation system—we're going to end up with a diminution in the number of units of certificates out there. The larger issue, of course, is the capacity to absorb replacement of the expiring certificates and have any dollars left over to expand the housing for very low-income families in the country.

The third issue I think is worthy of some discussion has to do with the Section 223F Co-insurance Program. Paul Adams referred to that a little bit this morning. I question whether or not the problems with Section 223F are due to poor underwriting, or whether it's a situation where standards are being overlooked by the underwriters because FHA is on the hook.

Finally, and again we talked a little bit about it this morning, is the whole issue of FHA-foreclosures. It may be a regional problem. There was a newspaper article a couple of weeks ago about 10,000 units allegedly in foreclosure in Denver. The Fort Worth Regional Office has around 5,000 units. Many of them are single-family homes. We're in a depressed housing market and those units are not going to be sold. Neither the home owners nor the investors have the wherewithal or the deep pockets to buy the housing and carry it.

I think we need to start looking at alternatives. I think we need to look at the issue of making FHA-acquired properties available to public housing agencies, lease purchase options, due-on-sale rehabilitation loans, and the like. I think the issue is whether to let them sit where they are and become vandalized and lose an asset because of neglect.

Those are really the kind of issues I think we ought to be looking at. I think it's important that the MIT papers and the Rouse report and the couple of other documents that are around become part of the library of GAO, as well as they are for us in the business, on the street, so that we're all pretty much up to speed on the current thinking.

Panel Members on Homelessness

Remarks of Dr. Langely Keyes, Professor of City and Regional Planning, Department of Urban Studies and Planning, Massachusetts Institute of Technology

Dr. Keyes: Almost a year ago, I was involved in a panel with Mike and Jim in which I also talked about homelessness. On the one hand, I don't want to revisit that paper and what I talked about then. On the other hand, I'd like to use it in some sense as a point of reference and simply to say that there is a paper which I wrote on housing and the homeless which is around. It's part of a housing policy project that I was involved in at MIT.

What I tried to do in the paper is set up a framework for looking at the homeless issue. Very simply, in looking at homelessness through the housing lens, you have to look at it in terms of three stages: a prevention stage, keeping people from becoming homeless; an emergency stage when they are homeless; and a stage three, which is when you put them back into housing, do they stay back in. Of course, this is greatly oversimplified.

There are, then, three kinds of homeless, but the thing that distinguishes them is really the extent to which they need service. The first kind of homeless are people who are homeless because they simply can't afford a place to live. If you found them a place they could afford, they would be okay. There would be no issue. That's economic homelessness. The second is what I call the situational homeless, people who are victims of abuse, who find themselves in some kind of transitional situation and need a little help from their friends. They don't need permanent help. And there's a third category of people, what I call the chronic homeless, who are going to need a lot more than a little help, who are permanently going to need help from lots of friends.

Basically, all over the world, families or individuals find themselves in one of these boxes. They're either about to become homeless; they are homeless and in the shelter system or on the streets; or they're people who, if you give them some money or a voucher and a little bit of supportive services, they'll be okay. Conversely, those in the final category, you've got to give them a lot more than that.

The two basic questions that have been asked are these: How many homeless are there now and how many can be anticipated in the future? Can they be categorized by cause? My argument is that the national figures have very little meaning, whether it's 3 million, 5 million, or

250,000. That really is not the significant question, although obviously it's a politically significant question. I think that numbers are critical but so are categories because of the implications they have for McKinney and sons and daughters of McKinney. That has to do with what kind of formula you use for distributing their money. You really don't know who's getting that money and how they're benefiting from it. So it seems to me that the numbers are important at the regional level, regional meaning metropolitan level within the states, because they really do determine where you're going to put the funds. It seems to me those numbers and how you get them and what kind of statistics, what kind of indicators you get at the metropolitan area as aggregated by the state, are really critical. But also the categories are important.

I think one can argue endlessly how many of the homeless in any given metropolitan area or any given city belong in the situational homeless category or belong in the chronic homeless category or are simply economically homeless. For example, it's interesting that the most recent Chicago study, looked at through this lens of three kinds of homelessness, shows that more people than we thought were homeless simply because they couldn't afford a place. A study that Rossie did a couple of years ago of Chicago said, gee, these people in my terms are really in the chronic and situational categories. They're people who need an enormous amount of help and they're not sort of ordinary people.

Some fundamental research is continuing, fundamental research which in Boston we call the debate between Bassick and the housing advocates. Translated, that means to what extent is this simply an issue of poverty and if you gave people more money they'd be okay. Dr. Bassick is a psychiatrist who's written a great deal about homelessness, and her conclusions were based on a lot of analyses of families in shelters. She said that you're dealing with people with an enormous set of social problems and social issues. They need a lot more than housing. The housing advocates who heard this when she unleashed it 3 years ago looked on the other side and said sure, they've got problems. You would have problems too if you had been living in a shelter for 6 months, but basically the issue is a housing issue.

I think that issue is going to be thought out at the local level in terms of the kind of indicators that states or metropolitan areas ask for, some kind of indication of their best estimate of how those people fall out in those categories, as well as more research to try to sort that issue out. How many homeless are there and how many can be anticipated is what you generate at the local metropolitan area. And it depends on how good

the formula is for determining what those indicators are. How many there are in the future has to do with how seriously you take those categories. If you take seriously the category of the economically homeless, then how many there are in the future has to do with the availability of housing. In my paper I talked about prevention of homelessness, of keeping people in the existing stock. The argument that the advocates feel very strongly about is that homelessness is basically a housing issue and, if there was more housing, whether it's more housing stock or housing vouchers or certificates, then we could deal with that.

What about the numbers of the situational homeless? "The situational homeless," I think, can be viewed as code for underclass. It's what used to be referred to as "problem people." You could argue that on the one end they're situational homeless who have a traumatic situation they've got to deal with, and on the other hand you've got people who have a serious set of problems they've got to deal with. So how big that category becomes depends on what you think about the future of the underclass.

And the chronic homeless—the category of drug abusers and alcoholics, the chronically mentally ill, that whole set of categories—seems to me one is kind of a residual category that has always been there, that probably always will be there. The size of it depends on what you think is going to happen around de-institutionalization or non-institutionalization. What is the future of that whole group of people who were either in institutions or never got in institutions but would have been if they hadn't blocked that. So once again, I think that what the numbers look like depends on what the causal factors are in determining those three categories.

I'm not going to tell you. I didn't tell you how many there were a year ago and I'm not going to tell you today. However, I have taken that issue more seriously than I did a year ago because it seems to me that you've really got to get the locals and the states to come up with some good numbers that are not based on the number of deteriorated houses.

Well, what is the federal government supposed to do? How well has it done? How well is it doing? How well can it do? And it seems to me that how well it's doing depends on how well it is able to reinforce the creation of a network at the local level of institutions, social services working cooperatively and collectively together with each other in a coordinated way to deal with the problem on a local level. Now, that's coming from my own experience in Massachusetts. What is needed,

what you want to have happening, is to have the locals being as coordinated and as responsive across the housing social service lines as you can.

And the issue for the federal government then seems to me is: What does it have to do to encourage and promote that kind of local coordination? You can say, hey, that's up to the locals. They've got to do it. But let's be realistic about it. How they're able to do it has a lot to do with how the federal government does its business, not only among yourselves, but also how it gets welfare people and HUD people talking to each other here so they're talking to each other there, locally. And one of the examples in my own vast experiences is when the local housing authority decides to evict Mrs. Smith because she hasn't paid the \$18 for rent that she's owed for the last 4 months. When the welfare department finds out about it, it says, gee, this is a real problem. Then somebody isn't doing what they ought to be doing to keep Mrs. Smith in public housing. Yes, you can say their getting together is a local problem. But I think there's a lot that can be done at the federal level to give the kind of signals locally to get the local public agencies, the housing authorities and the welfare folks, talking to each other.

Now, obviously the states have got to be doing the same thing and the locals have to be doing the same thing. But that kind of coordinated push at the local level, it seems to me, is critical. In the best of all possible worlds there ought to be a system in which the federal government is reinforcing the states in their creative entrepreneurial effort to set up mechanisms that get the locals doing this kind of cooperative effort. What you're doing is reinforcing the states who then reinforce the locals. The way the McKinney Act is set up now, it does a little bit of that and it does a little bit that isn't that.

My sense is that the housing concept papers that are before the Cranston Committee right now, doing more with flexible money and looking much more to the state, is the kind of direction that makes sense. What you want to do is to promote this local ecology, which is in fact enhanced by a state ecology, which is reinforced by a federal one, which is trying to get both of those working together locally.

I think that the process this year, the states getting involved in trying to figure out how to redo McKinney in a way to simplify, to make it more possible to do things, and then the response of the legislature around that, is a good example of the way the legislative process is supposed to work. The bill gets passed in an emergency period. It gets put out there.

It gets tried. People complain about it. They change it. Let it go ahead. But I think there's even more to be done.

I'd like to flag a couple of things that I think need a further look. One is transitional housing. Transitional housing was not given the currency and it's not going to get currency now. It's a lot of things to a lot of people. In New York City, it is something more than shelter but less than housing. It is something very different in Massachusetts, where transitional housing is housing for up to 2 years for people who aren't going to make it somewhere else. As soon as you're in a position to talk about the results of transitional housing and how it's working, that's a critical area to really be able to say something about. It's one that the states are concerned about and it's an important element.

I think another issue is the particular relationship of social services to housing. I believe the issue is prevention, keeping people from becoming homeless. It seems to me that preventing homelessness makes a lot of sense; you're better off dealing with them in existing housing rather than in shelters. I think the whole area of how to get states and localities to reinforce the prevention of homeless is one in which federal coordination could really help at the local level, getting welfare and housing agencies working together.

Finally, it seems to me critical that everybody recognize that homelessness is an umbrella word for a lot of other things. We're talking about drug abuse. We're talking about alcoholism. We're talking about mental health. We're talking about public health. We're talking about a lot of other things. I think it's critical that we not create what somebody said is sort of the homeless boutiques, not set up these individual programs, that deal with homelessness when really what we're dealing with is people who need mental health help, people who need to be in a drug program. What we don't need is a homeless system parallel to the public housing system. So it seems to me that as McKinney is revised, that the legislation that's before the Senate now moves forward, we try to find ways to integrate these related concerns and at the same time keep the attention on homelessness as a critical concern. public support that homeless families or the elderly have.

Remarks of Dr. James Stimpson, Deputy Assistant Secretary, Office of Policy Development, Department of Housing and Urban Development

Dr. Stimpson: Thank you. I'm delighted to be back on the panel with Dr. Keyes. As he noted, he had a session about a year ago when the MIT papers were being developed for the Cranston effort, and if you have not read Dr. Keyes paper, I recommend it to you. It's an excellent paper—one of the most thoughtful jobs in analyzing this issue I know of.

I thought I would make some general comments this morning on the McKinney Act—our experience with it this first year—and then some comments on the relationship of housing policies to the homeless. These comments will sound familiar to Dr. Keyes because he's heard some of them before.

About a year ago, here at HUD we were busily meeting every day getting the McKinney Act programs that were authorized underway. The McKinney Act was passed with a lot of fanfare and high expectations. It authorized over a 2-year period, \$1 billion—and then reality began to set in. The Congress appropriated somewhat less money than that for HUD. In fiscal 1987 we had \$195 million for the new HUD programs compared to the authorization of \$340 million. In the current year just ending, fiscal 1988, the Congress appropriated \$72 million compared to an authorization of \$280 million. So there were some high expectations raised, and I think that we've carried out the program expeditiously with the resources that have been available.

As soon as the McKinney Act was passed, within a month or so, Congress started asking us how effective it was. Most of you who are familiar with the McKinney Act programs and the administration of the programs know that the work really is just getting underway. Despite the fact that funds were allocated fairly quickly, it has taken time for the nonprofits and state and local organizations to use that money to get their programs underway.

But what has been our experience the first year and what are some of the questions that the McKinney Act has raised? I've already noted the prompt implementation. I think that the fact that within 3 months after passage of the act HUD had issued all of the requirements is a rather

remarkable record for HUD or for any federal agency. Funds actually got to the organizations in the communities after the first of the year, but they knew what they were getting by the end of the year.

The McKinney Act has resulted in targeting resources to special populations, particularly to the mentally ill or to homeless families and elderly. That was a requirement written into the act and our funds were distributed accordingly. The act focused on coordination and planning. Dr. Keyes referred to the need for coordination at the local level. With respect to the impact of the McKinney Act, the jury is still out. The McKinney Act for HUD programs requires every applicant or every eligible city and state to file a comprehensive homeless assistance plan, CHAP, and these were required to be filed last September. Again the states and cities moved very quickly. Organizations like COSCA and the Conference of Mayors had meetings around the country in which HUD participated, explaining the requirements and urging the cities and states to get their plans in.

Those plans vary greatly in quality. They were done very quickly. I think there is much more that could be done with respect to the CHAP process. We do know that the governors would like to review the city CHAPs. The cities have told us that they would like to review the state CHAP, and the nonprofits told us that they would like to direct the drafting of both the city and state CHAPs. But I think there has been some interaction, more interaction and more coordination and more discussion, but there's a way to go before it really becomes a good planning tool.

The McKinney Act also has helped all of us and helped policymakers define and sharpen the issue of how we should address the needs of the homeless. Immediately we began to hear from states and cities and nonprofits that the McKinney Act was too rigid. It's too categorical, and I think that's a general acknowledgement with the problems in the McKinney Act. The added flexibility did create some problems for nonprofits supplying these funds. As most of you I think are aware, there has been some discussion over the past 12 months of the desirability of moving to a block grant approach rather than continuing with this categorical, fragmented issue of funds. And in fact, a block grant amendment was offered in the House when the McKinney reauthorization bill came up on the floor and almost passed. It was a very close vote.

A block grant approach raises questions. What happens to the targeting of funds? Does a block grant allocation process result in more or less

efficient use of funds? In the last round of the Emergency Shelter Grant Program, which HUD administers using a CDBG formula, the total funding in fiscal 1988 was \$8 million. The state of Nevada received a grant total under that formula of \$7,000. That's hardly enough to put a bathroom facility in a shelter. Some communities' amounts were so low that they forfeited the amounts. They decided it would cost them more in paperwork to apply for those funds. So there are some questions that a block grant approach raises. I think it also raises a question of how to assure continuing services for the nonprofits.

I mentioned that the McKinney Act has focused on special population groups. It does a pretty good job covering emergency and temporary housing for families and the elderly. It is not as effective in its approach in providing for longer term support services or for permanent housing for those needing services. For example, there's nothing in the act addressing the particular problems of homeless youth or special problems. Granted some of these special problems could be addressed through HUD's transitional housing program, but that is a temporary, not permanent, housing program.

And finally, I think we have to acknowledge that, from a dollar standpoint, the McKinney Act really is only an enhancement. There are many cities that are putting more of their own money into the homeless program than the McKinney Act provides.

But to conclude on the McKinney Act, I think we do have to acknowledge that the act has provided more tools for the federal government, particularly for HUD, and it has helped to some extent to develop some new linkages between the public and private sectors.

The longer range issue is how we help individuals and families move from emergency shelters to transitional housing and then ultimately to permanent housing. And how do we connect the services that many of them need to re-enter the job market, to re-enter the community. That leads me to some of the comments I wanted to make on the relationship between the homeless and housing assistance policies.

Dr. Keyes mentioned that his paper addressed, particularly, prevention of homelessness and rehousing of homeless, and that debate has essentially looked at the homeless and their participation in the housing system. The basic strategy proposed for homeless prevention and for rehousing the homeless will only work I think for a small portion of the homeless, given the public policy relating to who is deserving of the

assistance. These strategies can work for families with children, for the chronically mentally ill, and for those who are involved with the social service and mental health system. There are a number of programs available to provide income support, food assistance, and housing assistance for families with children and for the chronically mentally ill.

Hopefully, linking these programs with housing can achieve the desired outcome of reestablishing these households in the communities. In some cases expansion of housing assistance programs may be necessary to avoid homelessness among these groups. To some limited extent, homelessness may be a housing policy issue. For example, homeless families may need rental assistance through a housing voucher in order to afford rent for a private market housing unit, or a community may need to expand its supply of suitable housing targeted for the chronically mentally ill in order to allow this population to move to a permanent housing arrangement.

We're working with a private foundation, for example, on a national demonstration to do just that. However, it's important to recognize that most of the homeless do not fall into the categories of what we often think of as the deserving poor for whom the public is willing to provide income and other supports. The homeless population is primarily single persons, mostly single men. Different studies estimate that between two-thirds and three-fourths of the homeless are single men; and single women constitute approximately 13 percent of the homeless population. We also know that homeless individuals are neither very young nor very old. Our 1984 study found that the average age of the homeless was 34. Other studies have found an average age of between 35 and 40.

These findings are important because, in general, public welfare systems are designed with the expectation that single persons in their productive years will be able to support themselves through employment. Those systems do not provide the kind of cash benefits for persons without families that are provided for families with children and for the elderly. Like other public programs, federal housing programs basically assume that single, nonelderly persons can take care of their own housing needs, and while single, nonelderly persons are eligible for housing assistance programs, they are in fact the last in line, after the elderly, after the handicapped, after displaced families, for housing assistance.

Even if federal housing assistance policies were changed to include single, nonelderly individuals among potential program beneficiaries on an equal basis with families and the elderly and the handicapped—and

that would add 2 million persons to those competing for this assistance—homeless single persons would probably be unlikely to benefit from this change because neither public nor private landlords would be likely to rent to them. As I mentioned, they have multiple problems that often make them unacceptable tenants. All the studies that I have seen agree that approximately one-fourth to one-third of the homeless are mentally ill. Dr. Rossie's Chicago study found that a third had been in a detoxification unit for alcohol or drug abuse. Our study found that 38 percent of shelter users had alcohol or drug problems, and another study found that 39 percent abused alcohol and 14 to 15 percent abused hard drugs.

So what we have is a population where over half the homeless adults appear to have the kinds of problems that would make it very difficult for them to participate in the normal housing system. Therefore, I think the needs of the single homeless have to be addressed through shelter or through longer term, supportive housing with services, not particularly through the provision of mainstream housing as we generally know it.

The federal government's appropriate role in homelessness is essentially to augment existing state and local structures by providing funding and other resources. Decisions on who to serve and how to serve them really have to be made at the local level. I think there's general agreement on this point since there is wide diversity among the homeless population in local areas. That diversity has been documented in a number of papers and in the U.S. Conference of Mayors' report, and it does require local solutions to specific problems of the homeless.

To conclude, while there are a number of income support and other programs that are available to aid the homeless, I would suggest that over time federally funded programs for the homeless may not be able to be used to meet the needs of the most dysfunctional among the single homeless. You can stimulate and supplement, but I think we will continue to need to rely on private sector organizations who have in the past been so active and have had a long-term history of providing assistance for this group.

The challenge and the difficulties in meeting the needs of the single homeless, who as I mentioned constitute a large proportion of the homeless population, will be to find ways to coordinate the resources and provide assistance without developing encumbering governmental restrictions. I don't think it will be an easy task because this is the group

that simply does not have the kind of public support that homeless families or the elderly have.

Remarks of John Sidor, Executive Director, Council of State Community Affairs

Mr. Sidor: I'd like to start off with the proposition that the problem of homelessness is not a problem of housing. I identified three sets or reasons why I feel that way and will talk about what that means.

The problem of homelessness is not a problem with housing. First, it's my belief that beginning approximately in 1973, this country really underwent a dramatic change in the economic structure and the demographic characteristics that only recently have been recognized and are only recently beginning to be grappled with.

Let me bore you with a few statistics. One, median family income in 1973 was \$30,820 and in 1987 was \$30,853—just about no change. Two, median wage for men in 1973 was \$28,607; in 1979 it was \$26,869, a drop; in 1987, \$26,008, a drop further. If you look at some of the sub-roots of a population, point number 3, the average income of families with households aged 25 to 34 declined by 12 percent from 1973 to 1986. For those households headed by people under the age of 25, their real income declined by 29 percent from 1973 to 1986, and for single-parent households with heads under age 25, their income declined by 36 percent between 1973 and 1986.

Since about 1979 or 1980, till 1986 or 1987, and depending upon what study you look at, the numbers vary a little bit differently and no one uses the same definition. But the pattern is real. A, weekly real wages have fallen 9 percent; B, the number of full-time workers who earned less than the poverty level has increased by 640,000; C, non-farm hourly earnings have dropped by 4.5 percent; and D, average weekly earnings have dropped by 2.4 percent.

Another point, in the last 10 years the real income of households in the bottom 20 percent of households relative to income fell 4 percent. Compare that with the last 6 years, in which workers with a college education have had a real increase in their incomes.

Another point, in 1967 the richest fifth of households took 40.4 percent of the income. In 1987 that was up to 43.7 percent. The poorest one-fifth

of households via income in 1967 took 5.5 percent of total income; that dropped to 4.6 percent of total income.

I think that's incredible. It's just a total reverse of the experience of over a generation of folks in this country. The education report that I recently read indicated that in 1920 the reading level you had to have to be functionally literate to get along in this world was at the fourth grade level. In 1940 that increased to an eighth-grade reading level, and it's expected in 1990 to require a twelfth-grade reading level. I think that all of us are aware of the talk about the number of people that are really illiterate and can't read very well. Clearly, unless you have access and have obtained some degree of education, your chances of holding a good job are very poor indeed.

At the same time, the real benefit of AFDC payments in this country declined by 33 percent between 1972 and 1987. We've had tightening of eligibility requirements for AFDC, for unemployment compensation, for food stamps, etc., while really the economic structure and wages for a lot of folks were declining.

As mentioned this morning, we've got tremendous problems with family violence, the breakup of families, drugs, mental illness. You know, I was at a conference where a head of a CDC of the inner city of Los Angeles and someone from the joint interpolitical studies agreed that by the time someone is 12 or 13 years of age and into drugs, they're irretrievable. I mean, that's something to think about. To me that's incredible. We have probably lost a whole generation of children that you can't get back into society once they've gotten into the drug culture at 12 or 13.

All right. Those were some statistics that I threw out to make the point that I think there's been a dramatic change in our economic structure and income levels in this country since about 1973.

Let me compare that with some housing cost data in terms of what happened between World War II and the early 1970s when there was really a rising real income for everybody. Since that time there's been declining real income for most people, particularly people that do not have education or are in the bottom fifth of the income quintile.

The median real contract rent basically stayed the same from about 1967 to 1984. In fact, the real median contract rent in 1985 was about where it was in 1972. Now, granted there have been recent increases in contract rent from 1981 to 1986; they've increased 16 percent. But there

really are some hot spots. Boston's rent increase was 25 percent, Los Angeles' 29 percent, San Francisco's 36 percent. Indeed, looking more long term from 1967 to 1987, the median contract rent in real dollars only increased a little over 8 percent. That's not 8 percent per annum, it's 8 percent for that 20-year period of time.

The number of vacant rental units, again using 1986 dollars, renting at \$200 a month or less has remained approximately the same from 1981 to 1986, about 400,000 units. The number of vacant rental units at \$300 a month in constant 1986 dollars has increased from a little under 800,000 in 1981 to over 900,000 in 1986.

Cushing mentioned yesterday that we've seen a rather dramatic increase in assisted housing over the last several years. I would have said from approximately 3 million in 1980 to 4 million in 1987. Other data show that assisted housing households went from 2.2 million in 1974 to 3.8 million in 1987, a rise of 73 percent.

Granted, the number of households that did not receive housing assistance that were poor, also increased. People earning \$5,000 or less who had no housing assistance went from 2.2 million to 3.2 million from 1974 to 1987. Those earning between \$5,000 and \$10,000 that were unassisted went from 3.8 million in 1974 to 4.5 million in 1987. I'm trying to show a pattern here that what we've had is dramatic changes since 1973. Most of those changes have dealt with income and wages. Housing, by and large, leaving home ownership or single-family housing costs aside, really has not increased that much. I don't think one can say, on the basis of these data, that the problem of homelessness is primarily a problem of housing.

Point number 2: What triggers homelessness? I see studies now and then that attempt to answer the question. There's an objective of trying to count the homeless and describe them. My guess would be, judging from the data that I've looked at, that housing—that is, a sudden and relatively sharp increase in rent or the demolition of a unit or its conversion—was not a significant cause of homelessness.

I think that what triggers homelessness is probably more income-related: a loss of wages or the need to spend money away from the ability to pay rent. For example, the recent report of the Virginia Coalition of Homeless found that the number one cause of homelessness in Virginia was unemployment. The number two cause was eviction, but the study did not get into a discussion of the type of eviction that took

place. This was a statewide report. The point I'm making here is that in the studies I've seen, the issue of what causes homelessness is not well-addressed. Where it does seem to be addressed, I doubt if you could say that homelessness is triggered by a housing-related cost primarily or solely. The third reason why we say the problem of homelessness is not a problem of housing is the characteristics of the homeless that were described this morning.

What do we do from this perspective? I would briefly like to identify four things. One, I really think we need to make some major changes in the number of fundamental institutions we have in this country unrelated to housing. I personally believe that the major domestic problem facing the next decade is how we relate to this changing economic structure and how we provide people with the skills and education to have decent jobs, how we use AFDC and unemployment compensation for economic development purposes, not merely as vehicles that are counter-productive from the point of view of economic development, or just try to maintain someone in a relatively good economic position. We're beginning to see some of that occurring at the national level and particularly at the state level.

Point number two was raised yesterday, and I really believe we've got to address this right on in the 1990s. I call it the multi-jurisdictional or institutional approach. Within a metropolitan area, how do we make sure that there is no racial discrimination or determination against people with children in housing? How do we deal with the growth management or slow growth movement that causes rapid increases in land prices and makes building affordable housing very difficult? I mean, we've got to be in a region where there is a real opportunity to build as much housing as is affordable without using government subsidies. I think that is really going to be a critical situation. How do we deal with standards that are too high? There was an interesting article in the New York Times where San Diego has had some tremendous private sector production over the last year, primarily because they reduced standards and allowed builders to build to lower standards. Even people that were not homeless are moving into the housing provided.

I don't think we can rely on single jurisdictions one by one to lower standards or to deal with this growth management issue. Where we do have assisted housing, I think we need to make sure that it is fair-shared—I hate that term. Housing should be allocated approximately within jurisdictions and regions. If we don't do that, I think that we're really going

to be in for a difficult time of dealing with affordable housing issues in the 1990s.

The third point I would make is that we really need to emphasize prevention of homelessness. I'm relatively amazed that here we are in the end of 1988 after a number of visible years of the homelessness issue, but prevention activities are ad hoc, non-systemic, scattered here and there, and are really marginal in terms of people trying to address the homelessness issue. I would err on the side of prevention. Any McKinney Act program, any program passed by the Congress that is designed to address the homelessness issue, ought to have some of its funds eligible for the prevention of homelessness. I really think we ought to try to encourage demonstrations to see if we can really find good ways to prevent homelessness. It's certainly a lot cheaper to do that than to deal with homelessness once it occurs.

Some states are doing a pretty good job. Lang mentioned Massachusetts. I think on paper the landlord/tenant relations with housing counseling, with re-identifying where there are possible housing resources, coming in with utility payments, etc., having early warning systems, I think we can do a pretty good job of effectively addressing the homelessness issue. New Jersey has a pretty decent state law that addresses the issue of prevention of homelessness that was just increased and expanded this year, but I think that sort of strategy is lost in much of what we do in homelessness.

The final point: Obviously I don't mean to be taking a position that we don't need more subsidized housing or low-income housing. I think that to some extent we do. I can only repeat some of the things that were said this morning that I concur whole-heartedly with, that indeed you're not going to solve the problem of homelessness simply by providing affordable housing. There's got to be a very strong social services connection to that. I did not get involved in this issue until earlier this year, and my first thought in meeting the people and discussing this was: Why is HUD getting involved in trying to house some of these difficult populations, the chronically mentally ill and people with alcohol and drug abuse? It didn't make much sense to me. I was sort of amazed to learn that HHS really has never had a shelter or housing program, that it's been left up to the states and their mental health agencies to try to deal with the issue as best they could. It seems to me you run into problems that were mentioned this morning by the public housing folks—that maybe the social services and human service folks and the housing folks have different agendas that may make it difficult to mesh those two. But in any

event, I think that the production of affordable housing, without a link to social services, is unrealistic.

Let me go back and identify those four points that I think were actually critical. One, making sure that throughout a region, all the jurisdictions have some minimal responsibility for racial and child discrimination. Two, that we have developed regulations or zoning whose main objective is to allow as much affordable housing to be built as possible in all the jurisdictions in a region. Three, that we have standards that allow people to build, to solve some of the low-income housing problems. Four, that we try to make sure that each jurisdiction in a region or metropolitan area gets its fair share of assisted housing or shelters.

I remember conferences I had with Mayor Royer from Seattle a couple of months ago where he said that 99 percent of the shelter beds in the Seattle regional area were in the city of Seattle, which meant that 99 percent of the people that used the beds were using them in Seattle. It's hard to believe that Seattle contributed 99 percent of the homeless cases in the region.

How do we get at those four things? I think that this is something that the Senate or anybody that tries to address housing in the next year from the point of view of revising the national housing policy, needs to really try to thoroughly think through and address. It seems to me that there are basically two ways to try to handle that. One is to try to hope that through some sort of mechanism you can get locals to agree to cooperate or have some sort of regional entity or authority that would do that. I think that is relatively unrealistic in most cases. I think the more realistic point to start at is state government for a variety of reasons—it's there. Constitutionally, they've got these kinds of authorities over local government. I know from my own experience these last couple of years that it's really become an issue with the state housing folks. They are getting more and more money for assisted housing, but it is buying less and less because it costs so much more. I think we've got to provide some sort of system of incentives which gives states more money for housing if, indeed, they start to take action that would try to reach the objectives of those four-fold points that I mentioned within jurisdictions in a regional area. Maybe there's got to be some group carrot. Maybe we should give states a much more, a much greater state housing folks. They are getting more and more money for assisted housing, but it is buying less and less because it costs so much more. I think we've got to provide some sort of system of incentives which gives states more money for housing if, indeed, they start to take action that would try to

reach the objectives of those four-fold points that I mentioned within jurisdictions in a regional area. Maybe there's got to be some group carrot. Maybe we should give states a much more, a much greater shot of what might be called median housing, politically good housing. If they're willing to make some hard choices, they get some of this sort of good stuff that everyone likes.

For some states that don't try to address some of these issues, there's got to be a system of incentives to direct it. One incentive could be tax-exempt bonds for single-family housing, but I think you've got to have a system of incentives that are out there for states to do this. Maybe once that gets started, you move in some sticks as well—I think it's got to be both the carrot and the stick—but I think you've got to start off first with the carrot before you move in with the sticks.

Remarks of Morris Bourne, Director, Office of Transitional Housing, Department of Housing and Urban Development

Mr. Bourne: I'd like to tell you about what HUD is doing. Understand that my comments are restricted to the supportive housing demonstration program—transitional housing to permanent housing for homeless handicapped, but GAO is pretty well versed in what we did because the statute required them to audit this and they are just finishing it up.

We've taken the limited amount of funds that were provided and we've spent it all as of last week with the exception of that portion deferred for permanent housing of the homeless handicapped. I think I agree with John that the homeless problem is just not a housing problem. What we've tried to do is, to the degree possible, force a federal, state, and local partnership or involvement, if you will, in dealing with these issues because just providing housing is not going to solve it and just throwing money at it is not going to solve it. You've got to have your mixed bag of services that the individual people need.

In the data that we have seen and the types of services being proposed, compared with the types of people they intended to serve, you can't come up with a straight line to save your life. The problem is at the local level and must be solved at that level. I want to make this point before I forget about it—please keep in mind that the McKinney Bill, certainly the supportive housing demonstration program portion of it, is a demonstration program. It's not a new building program for houses, and as we interpret it, our goal is to utilize it along with the cities and states and nonprofits where we get involved to try to identify and come up with

innovative ways to help deal with this issue. It is not to become another ongoing federal program that is going to take care of the problem of the homeless nationwide for ever and ever, amen.

So while we certainly want to help people, the only way we are going to resolve it is to house some people. Our objective is to try to find a way to work with the state and local governments and nonprofits and the other service agencies and other federal agencies to come up with some conclusion, some way to do it. Funding is limited. It's not 30-year money. It's short-term money. We award a grant at this point that includes operating costs subsidy. That's only for 5 years. There are no provisions at this time to increase that or extend it at the end of 5 years. The local government and/or sponsors, whoever is involved, is going to need to be prepared to go on with the program or get help from somewhere else. Maybe they can get it from HUD or something like it. There's a lot of things that can happen in 5 years, as we all know.

Anyway, during the past fiscal year, we funded 232 transitional projects around the country for \$119 million, and those are broken down by category served—100 projects for families, 71 projects for the mentally ill, 61 for other homeless individuals. The budget required that we allocate the funds in that manner and we've met the minimum in all categories. Now everybody wants results, but it's too early to give results.

On the permanent housing side, the states' rates of application are very, very disappointing. Of \$30 million advertised, we got requests for \$5 million, of which \$3.2 million was fundable. In April we wrote letters to all the governors and the territories telling them we were coming back with another round so they could have ample time to get their ducks in a row. In June we published the final regulation and the applications, and I sent that to them with another letter urging them to participate. We just closed that round August 30 and we got 62 applications, \$5 million. There's \$27 million available, and interestingly enough, of those 62 applications all came in from 23 states. So we made a little survey after the first round and did another one recently to see what the states' reasons were for not participating.

The first time around, the major problem was that states did not have enough time; it was a bad time of the year; they didn't have enough notice. This time they didn't have matching funds. Now there are 62 applications, 42 of them for less than \$100,000. Another 28 were under \$55,000, and at that pace, I am going to have permanent housing money from now until I retire and Congress won't have to approve any more.

So we're just going to have to take a hard look at this, and this maybe is something that GAO might want to take a look at, too. Maybe the program as it's currently structured is not getting the job done for a lot of reasons. One is that the states have problems, but not in the magnitude we all think. The other is that they have a problem, but they think if they wait long enough, the federal government will take care of it for them and they won't have to. I am not sure, I think it is too early to tell, and there could be a lot of reasons for the nonparticipation. I understand that one of the bills that is now proposed increases the cap from \$200,000 to \$400,000 in each program for acquisition and rehabilitation. I think that is a very notable gesture, but as long as we keep it on a 50/50 match and I can't get the state to match \$25,000, I don't know how I'm going to get them to match \$400,000.

The transitional housing program, incidently, is going great. We had more applications than we had money this time around, and based on the applications that are submitted over the next 5-year period, the funds we pull out should take care of about 40,000 people, assuming a 1-year stay.

Panel Members on Home Ownership Assistance Programs

Remarks of Dr. Patric Hendershott, Galbreath Professor of Finance, Ohio State University

Dr. Hendershott: Is FHA actuarially sound? Is FHA earning money or losing money? What, if anything, needs to be done to increase FHA's soundness? It reminds me of the debate we had earlier in the decade regarding Social Security. The ways FHA could increase its soundness, of course, would be to increase its fees, restrict its coverage, take less risky loans, require higher down payments, maybe not insure investment loans, and the like. It could also introduce some kind of co-insurance.

The other series of questions is, how can FHA's programs be altered to provide greater assistance to potential home owners? Can we lower the fees? Can we expand the coverage? Allow smaller down payments and take on riskier loans?

The tension between these two series of questions is obvious. Unfortunately, each series is reasonable. There is reason to believe that both FHA and the young potential home owners are in trouble. Thus, an easy resolution of the tension is not readily available because the first series of questions seems to overshadow the second series. How can we increase FHA's risk exposure if it is already in trouble? I will spend most of my time with that series of questions.

Why might someone doubt the soundness of FHA? I think in the last 6 months FHA did, for the first time in quite a while, record a loss, a very small loss, and that might be one thing. You might also look at the rate of foreclosures on single-family properties. These foreclosures have been rising at an annual rate of 30 percent for the last 5 years. In 1982 there were 19,000 foreclosures on single-family properties. Foreclosures have risen overall. It's gone to 28 to 34 to 45 to 55 to 70 thousand in 1987.

But I think the real reason one might be concerned about FHA is what's happened to the private mortgage insurance industry. Private mortgage insurers have taken large losses in the 1980's, owing to increased foreclosures. To compensate, the private mortgage insurance industry has raised fees, gone to lower loan value than anybody shows, cut out riskier loans, investments, and refinance loans, and so on. The private mortgage insurance industry has really struggled. It continues to record large losses in spite of these steps.

FHA, of course, insures riskier loans, has higher delinquencies and takes greater losses when default occurs. So how can FHA be making money when the private mortgage insurance industry seems to be being wiped out? FHA has obviously taken none of the corrective steps that the private mortgage insurance companies have taken. The only step FHA really has taken is an accounting change, not an economic change. In late 1981 FHA switched from charging a half percent premium. One-half percent of the mortgage balance was its old annual charge for insurance. It switched from that to a 3.8-point up-front fee. So instead of charging a half point over the life of the mortgage, it up-fronted the fee. Not only does FHA up-front its income but it backloads its losses. Losses are not recorded when loans become seriously delinquent, say over 90 days. They're not recorded when properties are foreclosed. They're only recorded when properties are sold. The homeless suit will actually increase FHA's profitability in the short run because FHA won't be able to sell properties and thus won't be able to record the losses.

I mentioned Social Security earlier, and I fear that some analogies with it may be appropriate. FHA may have ceased to be a pay-as-you-go insurance fund. Today's premiums may not build reserves for tomorrow's losses. They are paying for yesterday's bad loans. Of course, so long as FHA volume can be sufficiently accelerated, we can continue to pay for yesterday's problems. But I have two difficulties with this mentality. First, it's not clear that FHA was supposed to be a Social Security type program where current fees do not cover expected future costs. Second, if the demographics turn bad and loan originations turn down as well, as we know they will, FHA could be in deep trouble just as it became apparent that Social Security would be in deep trouble. The result, you may recall, is that we had a substantial increase in Social Security taxes. We may be seeing a very substantial increase in FHA fees down the road.

Well, what should FHA do? What should GAO do with its study of FHA? It seems to me GAO should attempt to restate the FHA's income statements for the 1980s. Just as Financial Accounting Standards Board Ruling 91 says that mortgage originators cannot up-front their fees in their income statements, FHA should not up-front its premiums. Also, defaults should be recorded long before the real estate is owned and sold. This restatement of earnings is needed to determine whether the FHA insurance fund is indeed solvent or has become a Social Security type program.

If FHA has become a Social Security type program, we need to develop some long-run Social Security type forecasts for FHA. We need to have some trustees for FHA. We need to do these projections out in time, make

assumptions regarding what originations will be for different inflation and demographic scenarios and so on and record what FHA's income would be. Along with that we need to use alternative assumptions regarding foreclosure rates. We could use the experience of 1957 to 1980 as a rosy scenario and the 1980 to 1985 period for an unrosy scenario. We could say what FHA's fund is going to look like under these different forecasts. It seems to me that the General Accounting Office certainly ought to get into these accounting issues.

Let me turn now to various proposals to alter FHA programs to better assist home owners. Remember, the question is, should FHA lower its required down payments, expand its mortgage types, and enlarge its ARM program? Possibly we could raise the FHA loan limits generally so we could expand the FHA market. You won't be surprised to hear me say that we ought to look carefully at what the increased risk would be associated with lowered down payment loans, ARMs, etc. Experience has taught us that higher loan value loans default more, and ARM loans are likely to default more. How large are these risks, and can FHA afford to take them?

I tried to get some data on recent default rates for FHA loans, by loan downpayment ratio and by different types of mortgages. Unfortunately, I wasn't able to get them and, as I understand it, FHA has a little trouble knowing what the loan-to-value ratios are on a lot of its loans. It is not clear that the data are there to allow that kind of analysis, but it is clear that this kind of analysis needs to be done. We need to know what risks we are taking when we change programs.

Let me conclude with a few thoughts on possible changes in FHA coverage. One change that would reduce FHA's risk without impacting negatively on either home ownership or the demand for housing generally: Cease underwriting refinancing loans where the borrower increases the loan amount. These loans are not stimulating ownership or housing demand, and private mortgage insurers have found that refinancing loans where borrowers increase the loan amount are riskier than other loans. A basic refinancing loan isn't risky, but if you refinance and increase the loan size, these loans tend to be riskier for two reasons. One reason is that there isn't a clear indication of what the value of the property is when you refinance. Because the property has not been sold, there's only an appraiser's estimate of what the property's worth as opposed to an actual sale. The other thing is that people who take equity out of their houses by getting larger loans are one type of people. The other type of people, like my wife, want to pay off the mortgage and

have a party. That's a very old, old thing in this country that I think the younger generation is not too engaged in, burning up mortgages. But to our parents, a big celebration was held when the mortgage was paid off. People, who are inclined to increase their debt, are more likely to default than people who don't increase their debt.

One of the most common proposals regarding FHA loan limits is that loan limits ought to be related regionally to regional house prices. Areas where house prices are high ought to have higher loan limits than areas where house prices are lower. There's a fallacy in tying a loan limit to the price of the house. Loan limits ought to be higher where real housing costs are higher, but house prices are higher in a lot of areas not because the costs of the constant quality house are higher, but because people have higher real incomes in those areas. House prices tend to be higher on the coasts than they are in the heartland, and it's not simply because the real cost of housing is higher. It's because people's real incomes are higher. It's not at all clear that we ought to alter the loan limits so the loan limit is higher in some areas simply because people have higher real incomes. We ought to be targeting the FHA program to people with real incomes below some amount. While we ought to have regional limits, they should be tied to the real costs of a constant quality house as opposed to quoted house prices.

Most expansions in FHA activity are rationalized as increasing home ownership opportunities. We believe strongly that home ownership is a good thing, that we ought to assist people to become home owners, but if we are going to expand FHA with that rationalization in mind, we ought to try and very carefully target the changes in FHA that will occur.

If we are going to increase loan limits to assist first-time home buyers, then we ought to have the higher loan limits apply only to first-time home buyers, not to anybody who happens to be out there. A general increase in loan limits obviously would not pass the test of careful targeting.

**Remarks of Philip Brownstein, Brownstein, Zeldman, and Schomer,
and Former Commissioner of the Federal Housing Administration**

Mr. Brownstein: Well, my view of FHA and its present state isn't very gloomy. I don't really think that it's in deep trouble. It's gone through a difficult period. Part of the difficult period is due to the fact that we went through a period of relative stability in the real estate market. FHA and VA from their inception have "benefited" from inflation. When

prices of real estate pretty well stabilized for a few years, then the defaults and foreclosures started. Of course, this was greatly exacerbated by the problems in the oil states.

It would seem that by now a good deal of the water has been wrung out in Texas and Louisiana and Alaska and Oklahoma. The rate of foreclosures and the rate of acquisition by FHA ought to be decreasing. I think that most actuaries would agree that the 3.8-percent up-front premium that is now being assessed should be adequate to cover anticipated losses. Of course, the reason why FHA did not show large losses during this period when it was paying a lot of claims was because of the whole theory behind insurance. It isn't that you make your money immediately, but rather it is your investment income which builds up over a period of time and which accounts for the fact that FHA has done as well as it has done during these difficult times of the last couple of years.

There's another thing I think we ought to bear in mind in the case of FHA and that is that there is a social purpose in many of the programs aside from fostering home ownership. For example, FHA's losses from such programs as section 223e home ownership in intercity areas are covered by FHA mortgage insurance funds. I'm not going to suggest that that's a bad idea. I see nothing wrong with using the profits—if you choose to call them that—from the standard FHA program in order to achieve some of these socially desirable objectives that are recognized to cause losses higher than you would otherwise expect in your standard program. And it's easy to have these things get out of focus.

I remember at one point in a congressional hearing, a high governmental official deploring the horrible foreclosure rate in the 235 program. This was the subsidized program, not for low-income buyers, but for moderate-income buyers who would have their interest rates reduced to 1 percent. The government subsidized the difference between the 1 percent interest rate and the market rate. The hand-wringing was done over the fact that the section 235 program had resulted in, as the official termed it, a failure rate of 10 percent and that was terrible. I followed him in the testimony and referred to his comment about the 10-percent failure rate. I suggested that if my arithmetic was correct, that must mean a 90-percent success rate, and how many government programs can claim a 90-percent success rate?

It is very easy to have these things get dramatized and brought totally out of perspective. I noticed in the notes here that there is over \$250 billion in insured mortgages outstanding by FHA or guaranteed by VA.

And I thought, yeah, there's been some abuse, but has there ever been any program, private or governmental, where \$250 billion has changed hands, where some of it didn't stick to the wrong fingers. I don't believe that the problem of abuse that one hears about is more excessive in the case of FHA than in many other governmental programs that all of us could point to.

While I wouldn't for a moment suggest that the vigilance and the care and the concern not be intensified on this, because it is terribly important, I do think that we ought to look at it in terms of what is being achieved, what are the objectives. We should try to keep it in focus with the overall picture of what happens in private or public programs of this magnitude. I don't know that I would tamper with increasing the mortgage insurance premiums. I think it is essential that there be programs of this nature.

The question was raised also about whether there ought to be additional vigilance on the direct endorsement program. I think that there is considerable vigilance on that now, and an interesting feature of that is that the default and foreclosure rate in the direct endorsement program is in fact lower than it is in the prior approval program. The reason is that the responsible mortgagees—and indeed most of them are responsible—are so concerned about retaining their direct endorsement authorization that they are being extremely cautious in what they are approving. Sure, some crooks will turn up now and then. I really don't know that in that particular area there is a need to go beyond where HUD is going now, which is, with some increased monitoring aimed at the mortgagees that are troublesome.

On the question of what we can do to foster home ownership and to increase the ability of first-time home buyers particularly, the questions that were raised on mortgage limits or reducing down payments or increasing the ARM aren't the problem. The problem is one of affordability, and the only way that I think you are going to increase home ownership is by increasing the ability of people to pay for it, which is going to involve a subsidy of some kind.

I know that every administration that I can recall, and I can recall a lot of them, has objected vehemently to any tampering with the tax code for purposes of achieving some social objectives, and I have no reason to believe that any incoming administration will change its position very much on this. But it seems to me that there are some things that can be done to increase the likelihood of people being able to achieve home

ownership with some adjustments of a tax code. One way is to increase savings, get savings into thrift institutions, make mortgages to home buyers easier by creating a small-savers tax shelter. Let a person put savings into a thrift institution and have a certain amount of that tax-exempt. There could be income limits and other eligibility criteria for those persons. Then require that the institution put those savings in the mortgages at some spread between the rate that it is paying the saver and the amount that it charges the mortgagor. I think that would increase savings, reduce the cost of borrowing to the mortgagor, and put a lot more people in a position of being able to afford to buy property. I think the way you have to get at it is through a subsidy of some nature, and I cannot think of a better one than that. But again, it would be difficult because of the aversion that so many have to using the tax code for that purpose.

I get a little bit troubled with the promotion of home ownership for very low-income families. I think home ownership is a great thing, but it carries with it responsibilities as well as a lot of privileges, and to saddle every low-income family with a mortgage is not going to help them very much. I think that it is important that ownership be preceded with counseling and education and an explanation of and a very, very clear, understanding of what you have to do in given conditions. You can have someone who marginally might be able to afford to make the mortgage payments, but what do they do when the water heater blows up? So it sounds good to say let's get all these public housing tenants into these units and have them own them, but be sure that they're in a position to accept the responsibility that will go with the ownership.

Now let me comment in conclusion on privatization. I don't believe that the federal government should engage in programs that are competitive with those that are being handled in the private sector. A lot of the mortgage lending in this country can be handled by private mortgage insurers, thus reducing somewhat the demands on FHA. But I don't believe that the entire gap can be taken care of or the entire need can be filled by private mortgage insurers. One need that has always evaded the private sector is the acceptability of an instrument that is as acceptable as Ginny Mae mortgage-type securities for tapping a lot of capital resources. Until the private sector can come up with a security that can tap secondary market sources such as Ginny Mae, then I think that, particularly in periods of tight money, it is going to be awfully difficult to escape a pretty substantial need for the participation by FHA. Maybe one of the things that could be looked at is making Ginny Maes eligible for mortgages that are insured by private mortgage entities.

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