Meeting Our Nation's Housing Challenges

Report of the Bipartisan Millennial Housing Commission
Appointed by the Congress of the United States

Submitted to the

Committee on Appropriations and
Subcommittee for VA, HUD and Independent Agencies

Committee on Financial Services and
Subcommittee on Housing and Community Opportunity

United States House of Representatives

Committee on Appropriations and
Subcommittee for VA, HUD and Independent Agencies

Committee on Banking, Housing and Urban Affairs and
Subcommittee on Housing and Transportation

United States Senate

Pursuant to Section 206(b) of Public Law 106-74, as Amended

Washington, D.C.: May 30, 2002

The Millennial Housing Commission

In December of 2000, the Congress of the United States, pursuant to legislation introduced by Representative James Walsh, established the bipartisan Millennial Housing Commission (MHC). Commission members were appointed by the chairs and ranking minority members of the House and Senate Appropriations Committees and Subcommittees for VA, HUD and Independent Agencies; the Senate Banking, Housing and Urban Affairs Committee and its Housing and Transportation Subcommittee; and the House Financial Services Committee and its Housing and Community Opportunity Subcommittee. The Commission was charged with examining, analyzing, and exploring:

"(1) the importance of housing, particularly affordable housing which includes housing for the elderly, to the infrastructure of the United States;

"(2) the various possible methods for increasing the role of the private sector in providing affordable housing in the United States, including the effectiveness and efficiency of such methods; and

"(3) whether the existing programs of the Department of Housing and Urban Development work in conjunction with one another to provide better housing opportunities for families, neighborhoods, and communities, and how such programs can be improved with respect to such purpose."

(P.L. 106-74, Sec. 206(b))

Note: At the same time that it established the Millennial Housing Commission, Congress created the Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century. The Seniors Commission was established to report on the housing and health needs for the next generation of seniors, and to offer policy and legislative recommendations for enhancing services and increasing the available housing for this rapidly growing segment of our society. It is scheduled to deliver its report by June 30, 2002. The Millennial Housing Commission deferred senior housing issues to the Seniors Commission.

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Letter from the Commission Co-Chairs

We have been honored to lead the Millennial Housing Commission during the past 17 months as we performed a thorough re-examination of the federal role in meeting the nation's housing challenges at Congress' request.

The 22 commissioners appointed to this task were drawn from across the country and from across the spectrum of housing ideologies and experience. We are particularly pleased, therefore, to have achieved concurrence among all but one of the appointed members. The Commission included former elected officials; participants on previous national commissions; housing researchers, builders, managers, and owners; planners and public administrators; and leaders of community development organizations. Our findings and recommendations obviously reflect the great diversity of philosophy and experience represented, but on one thing we all agree—we unequivocally care about housing and some fundamental precepts.

First, housing matters. *It represents the single largest expenditure for most American families and the single largest source of wealth for most homeowners. The development of housing has a major impact on the national economy and the economic growth and health of regions and communities. Housing is inextricably linked to access to jobs and healthy communities and the social behavior of the families who occupy it. The failure to achieve adequate housing leads to significant societal costs.*

Second, there is simply not enough affordable housing. *The inadequacy of supply increases dramatically as one moves down the ladder of family earnings. The challenge is most acute for rental housing in high-cost areas, and the most egregious problem is for the very poor.*

We recognize that our country is engaged in a war that affects our vital interests, and that we have experienced a serious economic downturn from which we are entering a tentative recovery. There is a serious public debate as to which tax and spending policies will best support the sound fiscal management that our nation requires. Even within this context, resources for affordable housing provide important economic, social, and societal benefits.

The inexorable growth in the numbers of families, of those working in service sectors, and of immigrants seeking to take part in the American Dream—coupled with community opposition to high-density development, the gentrification or abandonment and deterioration of an increasing percentage of our housing stock, and the growing affordability gap between haves and have nots—require that the Government of the United States seriously address the question of how our society can produce and preserve more housing for more American families in a more rational, thoughtful, and efficient way in the decade ahead. As affordable housing production is increased within the context of healthy, inclusive communities, the economy is strengthened, more families share common American values, and economic opportunity is increased for many.

We are pleased to present the Millennial Housing Commission's recommendations, which we hope will engage the elected officials of our democracy to meet these challenges.

May 30, 2002

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Executive Summary

Housing is most Americans' largest expense. Decent and affordable housing has a demonstrable impact on family stability and the life outcomes of children. Decent housing is an indispensable building block of healthy neighborhoods, and thus shapes the quality of community life. In addition, the housing sector provides a major stimulus to the nation's economy, consistently generating more than one-fifth of gross domestic product. Better housing can lead to better outcomes for individuals, communities, and American society as a whole. In short, housing matters.

This is why the federal government has long sought to expand the country's housing supply. Federal support for housing has taken many forms over the years: grants; subsidies on mortgage debt; direct payments to landlords on behalf of low-income citizens; the provision of liquidity and stability to the housing finance system through Federal Housing Administration mortgage insurance; the creation of the Federal Home Loan Banks, Fannie Mae, and Freddie Mac; and housing-related tax code measures, such as mortgage interest and property tax deductions, accelerated depreciation, tax-exempt mortgage financing, and Low Income Housing Tax Credits.

Federal support for the housing sector has been tremendously successful for most households. America's homeownership rate is a remarkable 67.8 percent. Direct federal assistance for rental housing now reaches 4.8 million low- and moderate-income families who cannot afford housing in the open market. The nation's housing stock is the envy of the world. More than one million additional affordable rentals are assisted through tax credits and block grants.

For many poor households, however, federal efforts have been less than successful. The most significant housing challenge is affordability, growing in severity as family incomes move down the ladder. In 1999, one in four—almost 28 million—American households reported spending more on housing than the federal government considers affordable and appropriate (more than 30 percent of income). Even working full time no longer guarantees escape from severe housing affordability problems. In 1999, one in eight lower-income working families earning at least the full-time equivalent of the minimum wage reported spending more than half their incomes on housing.

The gap between the available rental supply of units affordable to the poorest households and the demand for them stood at 1.8 million in 1999. Because they could afford nothing better, 1.7 million lower-income households lived in severely inadequate housing, placing their health and safety at risk. Finally, despite the 1990s homeownership boom, black and Hispanic homeownership rates in 2001 lagged the homeownership rate of whites by almost 27 percentage points.

Federal support for the housing sector has been insufficient to cover growing needs, fill the gaps in availability and affordability, preserve the nation's investment in federally assisted housing, and provide sufficient flexibility to craft local solutions to problems. For example, multifamily production in the 1990s was approximately half of its level in each of the previous two decades. As a result of this and the shift toward production of more expensive apartments, rentals affordable to low- and moderate-income households fell by 9.5 percent between 1985 and 1999, further thinning the supply of affordable housing. Federal efforts have often not provided sufficient cash flow and incentives to insure proper physical maintenance or continued affordability when relatively short-term subsidy arrangements expire. Many federal programs fail to reflect state-to-state variations in housing needs and costs, and they fail to motivate proper planning—planning that relates housing to educational and economic opportunities, as well as to transportation.

At the opening of the new millennium, the nation faces a widening gap between the demand for affordable housing and the supply of it. The causes are varied—rising housing production costs in relation to family incomes, inadequate public subsidies, restrictive zoning practices, adoption of local regulations that discourage housing development, and loss of units from the supply of federally subsidized housing. Rural areas and Native American lands present especially difficult environments for affordable housing because of the higher costs of providing infrastructure and the dearth of well-paying jobs. And despite civil-rights and fair housing guarantees, the housing shortage hits minorities hardest of all.

America's housing challenges cannot be described with statistics alone; they must be understood as a quality-of-life issues as well. Fundamental to the American Dream is somewhere to call home—a safe and welcoming "anchor place" where families are raised and memories are formed. Furthermore, housing must be viewed in the context of the community in which it is located. Improvements in housing need to be linked to improvements in schools, community safety, transportation, and job access.

Success in federal housing policy needs to be evaluated not just according to the number of housing units produced but also in terms of whether the housing produced improves both communities and individual lives. Federal housing assistance programs need to be reformed so that non-elderly, able-bodied people living in assisted housing have a personal responsibility, as do others, to contribute to society as well as accept its help. It is time for America to put these quality-of-life considerations on a par with cost considerations and make housing programs work to improve communities and individual lives.

In light of its mandate from Congress, the Millennial Housing Commission sought answers to some basic questions in seeking to address the nation's housing challenges:

- What is the importance of housing, particularly affordable housing, to the nation's infrastructure?
- Is the nation getting the housing outcomes it expects and desires for individuals, families, and communities? Are there better ways to meet these needs?
- How can the nation increase private-sector involvement?
- Are existing housing programs living up to their potential? Which need reform or significant restructuring?
- What are the critical unmet housing needs? Are new programs necessary to address these needs?

In the search for answers to these questions, the Commission held five public hearings, conducted numerous focus group meetings, commissioned papers, and solicited input on policy positions and program recommendations from a myriad of individuals and organizations. The consistent ideas expressed in these various forums were:

- Affordability and lack of decent housing are a growing problem, particularly for low-income families.
- Housing must be financially and physically sustainable for the long term.
- Housing issues are predominantly local issues, and programs must reflect the variations from state to state and community to community.
- Housing exists in a broader community context, and programs must consider the relation and impact of housing on education, economic opportunity, and transportation.
- Private-sector involvement in the production of affordable housing must be increased.
- Mixed-income housing is generally preferable to affordable housing that concentrates and isolates poor families.
- Consistent enforcement of the nation's fair housing laws is a vital part of making housing a part of the ladder of economic opportunity.
- Congruence among existing housing programs is essential.

- Homeownership counseling is necessary to make homeownership programs work well for low-income families.

These ideas are reflected in the Commission's recommendations to Congress.

*   *   *

This is not a report about specific funding levels, nor does it lay out quantitative goals. Instead, this report presents a new vision for the nation's housing. The Millennial Housing Commission's vision can be stated quite simply:

to produce and preserve more sustainable, affordable housing in healthy communities to help American families progress up the ladder of economic opportunity.

To achieve this goal, the Millennial Housing Commission recommends that the links between housing and the community in which it is located be strengthened, that authority and responsibility for making decisions about housing remain in the hands of state and local governments, that the role of the private sector in producing affordable housing be enhanced, and that the goals of sustainability and affordability be placed on equal footing so that continued affordability is no longer the enemy of proper physical maintenance. All affordable housing needs to be designed, financed, and managed to be sustainable over the long term. These policy principles underpin all of the Commission's recommendations to Congress. The recommendations made in this report also rest upon the assumption that every part of the housing, real estate, mortgage, and community development industries must operate without regard to race, color, national origin, gender, disability, family status, or religion.

A summary of the Commission's 13 principal recommendations follows. These recommendations are divided into three categories: new tools, major reforms of existing programs, and streamlining of existing programs. The policy principles of strengthening communities, devolving decision-making, involving the private sector, and ensuring sustainability inform all of the recommendations. The recommendations derive from nearly a century of experience. They represent lessons learned and a reaffirmation of the importance of housing to the nation as a whole, its communities, neighborhoods, families, and citizens.

New Tools

- **Enact a new homeownership tax credit.**

  The Commission recommends a state-administered homeownership tax credit, modeled on the successful Low Income Housing Tax Credit for rental housing. States would be able to use this flexible credit, under a qualified allocation plan, for two purposes. In qualified census tracts, where the cost to build or rehabilitate a unit will be greater than the appraised value of the completed home, states may use the credit to offset the developer's total development cost. A credit used in this manner would thus serve a community development purpose in addition to providing a new unit at a cost to the buyer that reflects local market conditions rather than the otherwise prohibitively high cost of development. Or, states may allocate the credit to lenders who in turn provide lower-cost mortgages to qualified buyers. In either form, the credit will extend the benefits of homeownership to low-income households and the communities in which they choose to live.

- **Support preservation with a broad system of tools, beginning with exit tax relief.**

  The stock of affordable housing units is shrinking. Some properties are in attractive markets, giving owners an economic incentive to opt out of federal programs in favor of market rents, and many owners have done so. Other properties are poorly located and cannot command rents adequate to finance needed repairs. In general, properties with lesser economic value are at risk of deterioration and, ultimately, abandonment, unless they can be transferred to new owners. To remove an impediment to transfer, the Commission recommends that Congress recognize and authorize "preservation entities," organizations that would acquire and own such properties and commit to the preservation of existing affordability. The Commission further recommends that Congress enact a preservation tax incentive to encourage sellers to transfer their properties to such entities. Subject to state housing finance agency oversight, an owner who sells to a preservation entity would be eligible for exit tax relief.

- **Provide capital subsidies for the production of units for occupancy by extremely low-income households.**

  This new tool would address the multiple problems of housing inadequacy that bear most heavily on extremely low-income (ELI) households, most of whom report paying well over half their incomes for housing costs. The most dramatic problem is the severe shortage of available units. No production program currently serves these households, and a significant portion of existing units that would be affordable to some of these families is occupied by higher-income households spending less than 30 percent of their incomes on housing. The capital subsidy would be used to produce new units and/or preserve existing units for ELI occupancy, eliminating debt on the units—and thus removing the debt service component from the household's monthly rental payment. No more than 20 percent of the units in any one development would have ELI occupancy restrictions. This program would thus result in more and better-quality units for ELI households and a degree of deconcentration of poverty.

- **Enact a new mixed-income, multifamily rental production program.**

  In most housing markets, an increase in the housing supply would be beneficial because it would lower rents at all price levels. Scarcity begets higher rents. The Commission therefore recommends a new multifamily production program with modest federal targeting requirements that, because of its relative simplicity, would attract private capital to produce multifamily rental housing. The essence of this recommendation is to take the limits off of states' ability to issue tax-exempt debt for specific housing and community development purposes. States may choose to allocate the resource via an allocation plan in order to target production to specific areas, such as those characterized by employment and other opportunities that would be particularly beneficial to the low-income families residing in the rent-restricted units.

- **Facilitate strategic community development by empowering state and local governments to blend funding streams.**

  State and local leaders have trouble coordinating affordable housing activities with transportation, economic development, employment, training, childcare, and educational activities, because funding for such purposes is delivered through separate federal-to-state funding streams. To facilitate the combined used of such funds in support of comprehensive neighborhood redevelopment, the Commission recommends that Congress authorize governors to set aside up to 15 percent of federal block grant funds received. Funds could be combined and used for specific projects developed with the support of local government(s). Funds would be used for the same purposes as they were intended (e.g., job training, childcare, transportation, housing, social services), but in support of comprehensive neighborhood redevelopment. Localities would undertake a comprehensive planning process with meaningful public input to create a holistic development strategy for a particular neighborhood. Projects selected would benefit from consolidated review and decision-making. Governors would have limited authority to waive federal regulations that interfere with the combined use of funds.

Major Reforms

- **Transform the public housing program.**

  Public housing agencies (PHAs) are encumbered by federal regulations that undermine local decision-making authority and make it difficult for PHAs to provide quality housing to low-income families. For example, the centralized system of public housing funding—wherein funds flow to PHAs as a whole and not to individual properties—makes it difficult for PHAs to finance needed capital improvements through the private markets. Meanwhile, federal funding for such activities has fallen short by approximately $20 billion to date. To transform the program, the MHC recommends a gradual transition to a project-based approach, with subsidies flowing to specific properties based on the rents that units would command after any needed renovation. This transformation would enable PHAs to rehabilitate properties using funds borrowed in private markets. If feasible, obsolete properties could be repositioned using the HOPE VI program. The recommendation also addresses troubled agencies, the program's overly complicated rent structure, and the disproportionate regulatory burden on small PHAs.

- **Revitalize and restructure the Federal Housing Administration within HUD.**

  Revitalizing and restructuring FHA is an urgent priority for congressional action. FHA's multifamily insurance is an indispensable tool for stimulating housing production, and its single-family insurance extends homeownership opportunities to low-income families and minorities. FHA's potential, however, is limited by its outmoded structure and confining statutes. The Commission therefore recommends that Congress restructure FHA as a wholly owned government corporation within HUD, governed by a board chaired by the HUD Secretary. Such a structure would enable FHA to adapt its programs to evolving markets without relying on Congress to legislate each change, and it could be accomplished with no substantial budget impact. It would also enable FHA to invest in technology, leading to increased efficiency and reduced risk, and to attract and compensate staff at competitive levels, securing the skills needed to manage its nearly $500 billion mortgage insurance program. Equally important is that under such a restructuring the FHA would remain with HUD and would be an effective force for the production and preservation of affordable housing. The Commission also outlines recommendations intended to provide FHA with more flexible multifamily and single-family operations. If Congress chooses not to restructure FHA, the MHC recommends that its proposed improvements be implemented within the current FHA organization.

- **End chronic homelessness.**

  Homeless families and individuals generally fall into two categories: the transitionally homeless and the chronically homeless. Transitionally homeless households need adequate housing, first and foremost, while those who are chronically homeless confront health or substance abuse problems in addition to extreme poverty. With its capital subsidy for units targeted exclusively to extremely low-income households and its recommended improvements to public housing, vouchers, and the HOME and Low Income Housing Tax Credit programs, the Commission believes that the tools needed to end transitional homelessness will be available. For the chronically homeless, permanent supportive housing, which combines housing with intensive rehabilitative and other social services, is needed. The Commission recommends the elimination of chronic homelessness over a 10-year period by the creation of additional units of permanent supportive housing and the transfer of renewal funding for such units to HUD's Housing Certificate Fund.

- **Over time, establish a work requirement linked to housing assistance.**

  As with other "means-tested programs," a household qualifies for housing assistance based on its income. Housing programs that set rents at a percentage of household income create a disincentive to increase income through work or marriage and a powerful barrier to household movement up the ladder of economic opportunity. The Commission recommends several measures to move assisted families up and out of assisted housing units, over time, through a combination of work requirements and supportive services, enabling them to increase their incomes and freeing up the housing units for other, currently unassisted families. In addition, the Commission recommends continued experimentation with and changes to the rent structure of public and assisted housing to reduce the disincentives to work and marriage.

Streamlining of Existing Programs

- **Expand and strengthen the housing choice voucher program.**

  The voucher program serves 1.6 million households and is for the most part highly successful. In some markets, however, program administration and regulatory complexity create an effective disincentive for private owners to accept voucher-holding tenants, especially when owners can instead rent to unsubsidized tenants. The Commission recommends increased authority for local program administrators to change payment standards in response to market conditions, and, recognizing the versatility of the program, it proposes measures to match voucher holders with services that complement efforts to embrace employment and other opportunities. Additional recommendations strengthen and enforce the requirement that owners of housing produced with federal assistance accept voucher-holding households—including extremely low-income households, for whom the Commission recommends a special type of voucher—in all cases subject to a local cap to encourage deconcentration of poverty. Finally, the Commission asserts that the voucher program is distinctly worthy of additional funding in substantial annual increments.

- **Reform the HOME and Low Income Housing Tax Credit programs, and increase funding for HOME.**

  The HOME and Low Income Housing Tax Credit programs are both highly successful. Outdated rules and regulations, however, inhibit their potential for production and preservation activities, particularly those that would provide new or rehabilitated units affordable to the lowest-income households. The Commission recommends elimination of these rules and of programmatic complexities that burden project developers and owners. In the case of the tax credit, the Commission recommends elimination of uncertainties that can spoil investor appetite. To support the efforts of former welfare recipients, the Commission calls for a change to the tax code to allow states to use Temporary Assistance to Needy Families (TANF) funds for one-time grants to tax credit properties. The grants would be used to reduce the rents on particular units, which would be occupied by working poor, including former welfare, households. In the case of the HOME program, the Commission recommends substantially increased appropriations.

- **Improve the Mortgage Revenue Bond program.**

  State housing finance agencies (HFAs) issue Mortgage Revenue Bonds (MRBs) and use the proceeds to generate single-family mortgages. A statutory provision known as the "10-year rule" limits HFA use of scheduled repayments and mortgage prepayments and has resulted in substantial lost mortgage volume to date. This provision should be repealed immediately. In addition, as long as income limits are enforced, the Commission recommends repeal of purchase price limits, as well as restrictions that limit eligibility to first-time homebuyers and restrictions that apply in some states and limit eligible Veterans. These measures combined will help to ensure that HFAs maximize the public benefit associated with bond issuance in the interest of promoting homeownership for low-income families.

- **Revise federal budget laws that deter affordable housing production and preservation.**

  Budget laws inhibit the U.S. Department of Housing and Urban Development (HUD) from entering into contracts requiring more than one year's funding. As a consequence, HUD cannot offer the owners of multifamily housing multiyear contracts for rental assistance, and owners cannot obtain financing on the terms most advantageous for capital investment in the affordable housing stock. As a practical matter, Congress has never failed to appropriate funding to renew existing contracts for rental assistance. The Commission recommends, therefore, that funding for rental assistance be moved to the "mandatory" category of federal expenditures, so that private-sector lenders will be willing to finance repairs. The MHC suggests alternate measures that would have the same effect.

In addition to the principal recommendations described above, the Millennial Housing Commission endorsed a number of supporting recommendations: increase funding for housing assistance in rural areas; increase funding for Native American housing; establish Individual Homeownership Development Accounts to help more low-income households buy homes; allow housing finance agencies to earn arbitrage; exempt housing bond purchasers from the Alternative Minimum Tax; undertake a study of Davis-Bacon Act requirements; address regulatory barriers that add to the cost of housing production; streamline state planning requirements for community development programs; expand the financing options for small multifamily properties; foster a secondary market for development and construction lending; launch a demonstration project for comprehensive community development; improve consumer education about home mortgage lending; improve the access of manufactured home buyers to capital markets; affirm the importance of the Community Reinvestment Act; and affirm the importance of the government-sponsored enterprises.

Why Housing Matters

Securing access to decent, affordable housing is fundamental to the American Dream. All Americans want to live in good-quality homes they can afford without sacrificing other basic needs. All Americans want to live in safe communities with ready access to job opportunities, good schools, and amenities. All parents want their children to grow up with positive role models and peer influences nearby. And the overwhelming majority of Americans want to purchase a home as a way to build wealth.

The importance of helping more Americans satisfy these objectives cannot be overstated. Decent, affordable, and accessible housing fosters self-sufficiency, brings stability to families and new vitality to distressed communities, and supports overall economic growth. Very particularly, it improves life outcomes for children. In the process, it reduces a host of costly social and economic problems that place enormous strains on the nation's education, public health, social service, law enforcement, criminal justice, and welfare systems.

Housing very much matters—to the individual, to the family, to the neighborhood, and to the nation.

Family Stability and Childhood Outcomes

Decent, affordable, and stable housing promotes family stability and creates a positive environment for raising children.[1] Families lacking the means to pay for good-quality housing may have to make frequent moves in search of appropriate accommodations. Two studies have found that disruptive moves during childhood and adolescence have a strong negative impact on school performance.[2] In addition, struggles to provide for daily needs also interfere with both school and job performance.

Although only a handful of studies have examined the impact of rental housing assistance on the transition from welfare to work, the available research suggests the effect is positive. Two studies point to a positive employment impact even in the absence of work supports such as childcare.[3] One analysis conducted in Minnesota, comparing the unemployment rates and average earnings of welfare-to-work recipients with and without rental assistance, found that the combination of housing and job assistance resulted in much more favorable employment outcomes.[4] The evidence is therefore mounting that stable, affordable rental housing plays an important role in helping families find and hold jobs.

Other research suggests the stability that homeownership brings can have especially positive effects on school success and social behavior.[5] All else equal, children of parents who own their homes and live in neighborhoods with low turnover have a higher probability of completing high school.[6] Teenaged daughters of homeowners are also less likely to become pregnant.[7] Even after controlling for parents' age, income, and other influences, homeowners' children have significantly higher math and reading scores as well as significantly fewer behavioral problems and a better quality home environment than renters' children.[8]

The physical condition of housing makes a difference for families as well. Better-quality housing is related to lower levels of psychological distress, which in turn reduce health care costs and improve productivity.[9] In contrast, housing that exposes families to hazards such as lead paint can limit lifelong educational and economic achievement.[10] The presence of dust, molds, and roach allergens in the home increases the incidence of asthma and allergies, while electrical problems, poor lighting, and other system deficiencies increase the risk of illness, injuries, and even death.[11]

Neighborhood Quality and Access to Opportunity

The vast majority of Americans live in communities with good-quality schools and ready access to jobs. But for millions of households, particularly those living in high-poverty urban or rural areas, such opportunities are severely limited. Unemployment, crime, high-school dropout, and teen-pregnancy rates are all significantly higher in these locations.[12] The incidence of post-traumatic stress disorder, depression, and anxiety among inner-city youth is also higher.[13] These problems make it especially difficult for local residents to find decent paying jobs and to improve their lives by saving enough to invest in homeownership, higher education, and other wealth-enhancing measures.

As a result, neighborhood quality plays an important role in positive outcomes for families. Stable housing in an unstable neighborhood does not necessarily allow for positive employment and child education outcomes. Federal demonstration programs enabling the poor to move from distressed city neighborhoods to lower-poverty communities underscore the potent impact of neighborhood quality on family stability. Research from the Gautreaux and Moving to Opportunity demonstrations indicates that relocating families to better neighborhoods can improve educational, mental health, and behavioral outcomes.[14] Evidence of the impact of these programs on employment, however, is mixed.[15]

Neighborhood Revitalization

While relocating lower-income families is one way to support economic independence and individual advancement, so too is the revitalization of distressed neighborhoods. Without strengthening schools, providing access to services, and connecting residents to jobs, housing development by itself cannot provide a platform for opportunity.

Both theory and empirical evidence suggest that when several owners fail to maintain their properties, others nearby follow suit because their neighbors' inaction undermines property values. Rundown and abandoned properties can have a contagious effect that accelerates neighborhood decline.[16, 17]

Replacing or upgrading distressed properties is therefore a precondition for neighborhood revitalization. Indeed, public investment in housing often triggers private investment that ultimately lifts property values.[18] Although larger economic and social forces can undermine such efforts,[19] recent comprehensive community development projects point to the potential for concentrated public investment in mixed-income housing as a cornerstone for reclaiming neighborhoods.

Household Wealth

Homeownership not only insulates families from rising rents and home prices, but it also enables them to build financial resources that can be tapped for other purposes. In 1998, 50 percent of the average homeowner's net worth was in home equity.[20]

By refinancing their mortgages, owners can reduce their monthly payments and/or take out equity—freeing up cash for other spending and investment. In 2001, families saved $10 billion in mortgage interest payments by refinancing their existing mortgage debt, for an average monthly savings of $100 over the life of the loan.[21] In addition, homeowners cashed out more than $100 billion in equity through refinancing, using the proceeds for debt consolidation, home improvements, consumer purchases, investment, and other purposes that helped to stimulate the economy.[22]

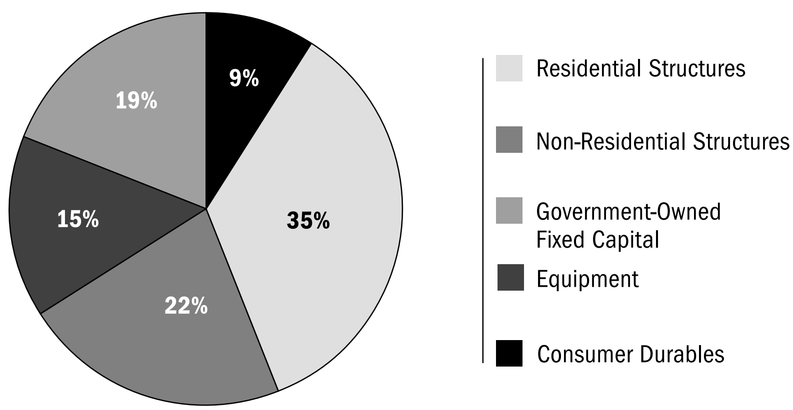
Capital gains on home sales also add liquidity to the economy and stimulate consumer spending. In 1999, the Federal Reserve Board estimated that the capital gains on an average home resale, net of transaction costs, exceeded $25,000.[23] With existing home sales running at well over 5 million annually, realized capital gains now put an additional $125 billion per year into sellers' bank accounts or toward the purchase of trade-up homes.

Contribution to Economic Growth and Stability

Beyond its benefits to families and communities, housing is an engine of the national economy and crucial to its strength. The residential housing stock itself represents more than one-third of the nation's tangible assets (Fig. 1). Just as important, the housing sector—including residential investment, housing consumption, and related spending—consistently generates more than 20 percent of the nation's gross domestic product (Fig. 2).

Figure 1

Housing Makes Up More Than a Third of the Nation's Tangible Assets



Source: Bureau of Economic Analysis, Survey of Current Business, September 2001.

In 2000, investment in home building and remodeling accounted for about 4 percent of GDP. Housing consumption, in the form of payments by renters and equivalent payments by homeowners, contributed nearly another 10 percent.[24] And spending on utilities, furnishings, appliances, and landscaping not otherwise captured amounted to more than 7 percent of GDP.

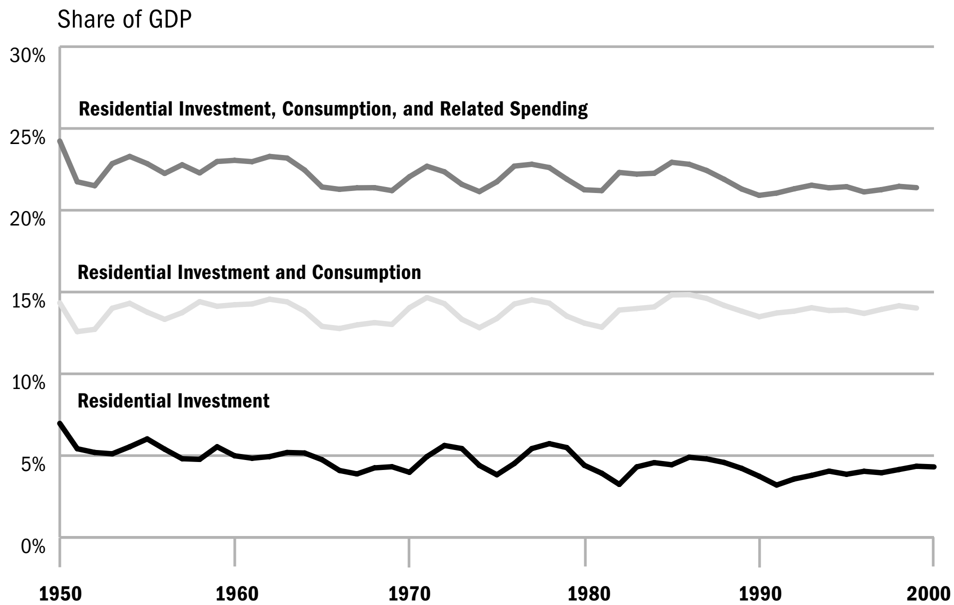
Housing production stimulates employment growth. In 2001, new residential construction was associated with roughly 3.5 million jobs nationally and $166 billion in local income.[25] The National Association of Home Builders estimates that the construction of 100 single-family homes supports about 250 full-time equivalent jobs and $11.6 million in wages.[26] The families occupying these new homes then bring an estimated $2.8 million in income and 65 jobs to the local economy.

Home building activity also adds significantly to federal, state, and local revenues. In 2001, home building was the source of about $65 billion in combined taxes and fees. Once constructed, housing continues to contribute to local government coffers through the property taxes—as well as the income, sales, and excise taxes—that homeowners pay. Such taxes amount to nearly $500,000 annually per 100 single-family units constructed.[27]

In the last 20 years, the nation's housing finance system has become a mainstay of the economy. Once subject to frequent credit crunches, the system today serves as a critical stabilizing force, relying on global capital markets rather than volatile local savings deposits. The system now manages risk better, provides expanded access to mortgage credit, and ensures that financing is continuously available even in the midst of international credit swings. As a result, U.S. citizens are some of the best-housed people in the world.

Figure 2

Housing Consistently Conributes More Than a Fifth of GDP



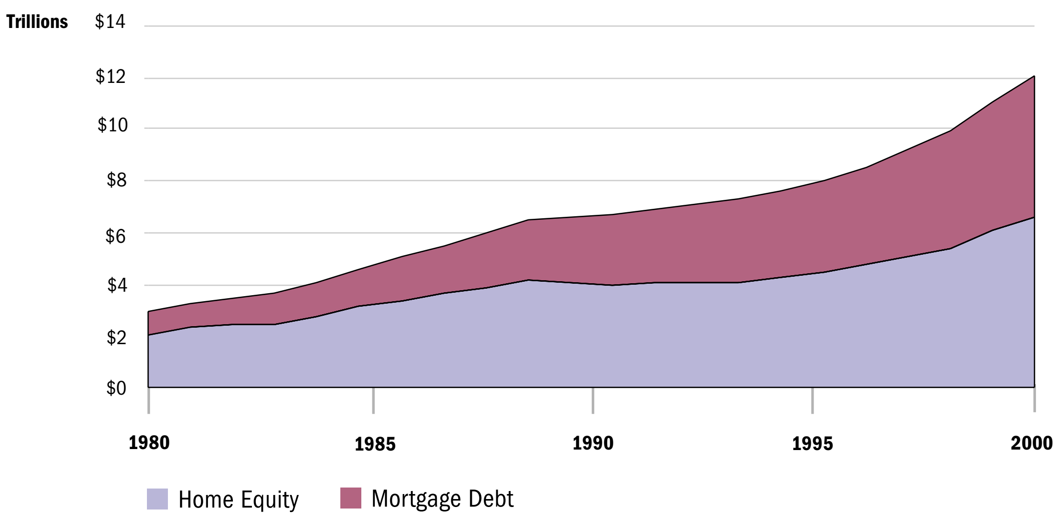
Note: Calculation includes use of gross residential investment, housing expenditures, and household operation expenditures, 1950-2000.

Source: Bureau of Economic Analysis, Personal Consumption Expenditures by Type, Gross and Net Investment by Type, October 2001.

Not only does the nation's housing finance system provide unparalleled access to mortgage credit, but by doing so it also strengthens the overall economy. Without continuous access to mortgage credit on favorable terms, the nation's nearly $12 trillion investment in household real estate would be vulnerable to depreciation[28]—with cascading effects on home equity, consumer confidence, and the overall financial system (Fig. 3). Uninterrupted access to development and construction finance also helps to prevent disruptive swings in building activity.

Figure 3

Both Home Equity and Household Mortgage Debt Stand at Record Levels



Source: Federal Reserve, Federal Flow of Funds Data, Historical Data.

For consumers, today's narrower spreads between interest rates on mortgages and Treasury securities have provided great savings. The introduction of automated underwriting has also led to lower origination and servicing costs. These benefits largely derive from the evolution of strong secondary markets. The federal government has developed a variety of mechanisms to ensure that Americans have continuous access to affordable credit, including the creation of Fannie Mae and Freddie Mac, mission-driven secondary-market companies dedicated to providing liquidity to mortgage markets and contributing to meeting affordable housing needs.

The Federal Housing Administration (FHA) is also a central player, reaching many underserved households that private lenders can not or do not reach. Together with Ginnie Mae, its secondary-market agency for packaging and selling loans, FHA has been the innovator of many mortgage products, insurance products, and mortgage-backed security designs that are now the mainstays of the housing market. Finally, the Federal Home Loan Banks (FHLBanks), also mission-driven, support residential lending through their members/shareholders.

The stabilizing force of the housing finance system was apparent in the most recent economic cycle. When the economy softened in 2001, mortgage refinances and home sales helped to offset broader economic weakness, and residential investment remained steady. Following the events of September 11, 2001, Fannie Mae and Freddie Mac kept capital flowing even when stock and bond markets shut down.

To reiterate, housing does matter—in every aspect of society. For this reason, the Millennial Housing Commission is convinced that investment in housing production, preservation, and assistance will prove to be a cost-effective and life-enhancing investment in the future—and particularly for those millions of households who are otherwise unable to obtain decent, affordable, and stable housing.

America's Housing Challenges

Although the vast majority of Americans is exceptionally well housed, millions of families still have serious housing problems. Affordability is the single greatest housing challenge facing the nation. In 1999, one in nine households reported spending more than half its income on housing, while hundreds of thousands went homeless on any given night. Wide gaps also remain between the homeownership rates of whites and minorities, even among those with comparable incomes. And while greatly reduced from a few generations ago, housing quality problems also persist.

In an effort to reduce housing costs for lower-income households, the federal government has gone from assisting fewer than 100,000 renters before the 1950s to providing direct assistance to nearly 5 million today. The government also assists more than one million additional rental units through tax credits and block grants. Nevertheless, only about one in three households eligible for rental assistance receives it.[1] In addition, hundreds of thousands of federally subsidized apartments are in very poor physical condition, starved of cash flow to meet backlogged repairs so that they are at risk of loss.[2] And one million privately owned apartments are under short-term federal subsidy contracts that allow owners to exit the program and convert their properties to market rents when the contracts expire.

The nation's lowest-cost rentals, along with those affordable to low- and moderate-income renters, are being lost at alarming rates. Preservation of the remaining affordable rental stock has thus taken on a new sense of urgency, as has the need to stimulate production of new rental housing. Gaps between the supply of and the demand for affordable rental housing are greatest for extremely low-income households, but losses of housing affordable to low- and moderate-income households underscore the need to stimulate rental production for all three income groups. Currently, however, no federal program is dedicated to preserving or producing housing for extremely low- or moderate-income households.

Adding to affordability problems, house price increases since the 1980s have outstripped income growth. Partly as a result of this, and partly as a result of the fact that many new homes are too expensive for lower- and moderate-income Americans to buy, the number and share of homeowners with housing affordability problems now stand at record levels. Moreover, these increases have occurred despite significant reductions in mortgage interest rates.

The other most significant housing challenge facing the nation is the gap in homeownership rates between whites and minorities, as well as between high- and low-income households. Not all households that want to buy homes and are capable of managing the responsibilities of homeownership have been able to do so. Homeownership has the potential to help families build their assets and wealth, stabilize their housing costs and living arrangements, and gain greater control over their home environments. A balanced housing policy must therefore make addressing both the homeownership gaps and the rental affordability challenges urgent national priorities.

Definitions of Income Groups Used Throughout This Report

Extremely Low Income	(ELI)	=	Below 30 percent of area median income (AMI)
Very Low Income	(VLI)	=	30.1 to 50 percent of AMI
Low Income	(LI)	=	50.1 to 80 percent of AMI
Lower Income			Less than 80 percent of AMI
Moderate Income	(MI)	=	80.1 to 120 percent of AMI
High Income	(HI)	=	Above 120 percent of AMI

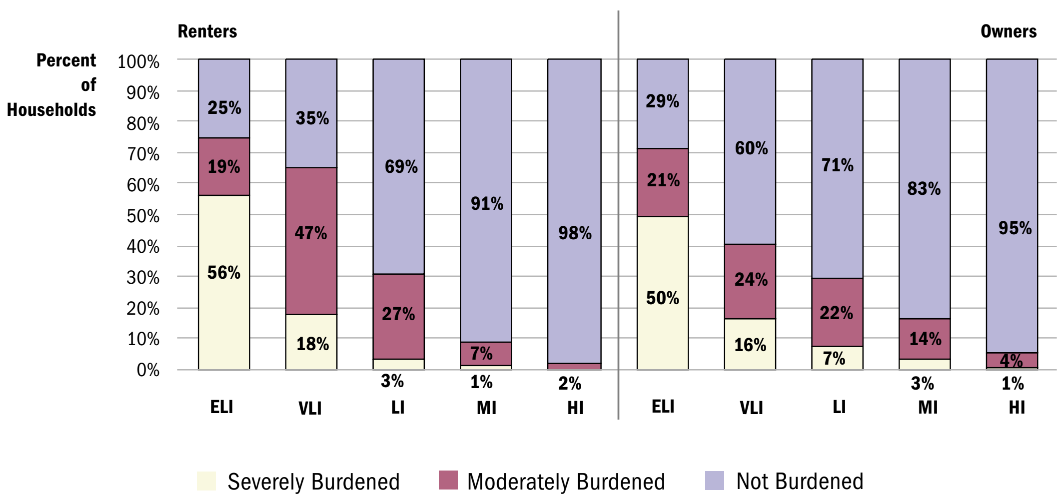
Scope of the Affordability Challenge

Most federal programs measure affordability by the relationship of income to housing costs. Spending 30 percent to 50 percent of income on housing is the generally accepted definition of a moderate affordability problem; spending more than 50 percent is a considered a severe affordability problem. In reality, however, spending more than 30 percent of income for many lower-income households is a significant hardship that prevents them from meeting other basic needs or saving and investing for the future.

Under these definitions, 13.4 million renter households and 14.5 million owner households have housing affordability problems (Fig. 4). For cost-burdened renters, the struggle is to pay rent and utilities; for cost-burdened owners, the problem is keeping up with property maintenance as well as holding onto home equity.[3] Elderly and disabled owners, in particular, may be unable to perform the upkeep necessary to keep their homes in good repair.

Figure 4

Many Owners as well as Renters Face Severe Affordability Problems



Source: HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

Households cannot afford housing for several reasons. In some cases, their incomes are too low to cover even modest rental housing costs. In others, they live in high-cost markets where having even a moderate income is insufficient to afford housing. In yet others, working families are unable to earn enough wages to manage their housing costs and basic needs because of age, disability, or difficulty finding full-time jobs.

In rare instances, families may choose to spend more than 30 percent of their incomes on housing simply because they consider it a top priority. But the fact that the average American household in 1999 devoted only about 20 percent of income for housing suggests that spending more than 30 percent is bred of necessity, not choice.

Federal housing policymakers have responded to these affordability challenges in a variety of ways: by producing additional units, by preserving existing low-cost units, and by assisting families in paying their rents or mortgages. While the Commission endorses such a balanced program, it has also concluded that more can and should be done to couple housing programs with measures to increase employment opportunities for working families and expand affordable housing options in areas of rapid job growth.

Measuring Affordability

Housing affordability is clearly a serious and growing national concern plaguing millions of Americans. Official estimates and those used throughout this report, however, overstate the magnitude of the nation's affordability problems, especially among lower-income households.

There are two reasons for the overestimates. First, the American Housing Survey (AHS), which was used to produce the estimates, undercounts income—perhaps by as much as $329 billion or more, or 14 percent of total money income.[4] Second, the estimates are based on housing costs as a share of *pre-tax* income. This leads to overstating the housing affordability problems among many of the more than 19 million low-income families that take the earned income tax credit (EITC), many of whom have higher after-tax than pre-tax incomes. It is also worth noting that noncash benefits, such as food stamps, are not counted toward income in determining eligibility for housing programs and therefore in estimating housing cost burdens.

Recent research suggests, however, that including the EITC has only a modest impact on estimates of "worst-case housing needs."[5] HUD defines households with worst-case housing needs as very low-income unassisted renters spending more than half their incomes on housing or living in severely inadequate units. This research reveals that correcting for the EITC reduces the number of worst-case needs in 1999 by only about 7 percent.[6]

During the preparation of this report, the Commission roughly simulated the impact of income undercounts. In one simulation, the Commission adjusted all incomes upward to account for the estimated 14 percent average understatement of income. This reduced the number of worst case needs by 18 percent. In a second simulation, the Commission deleted every household reporting income of $1,000 or less, a rent of less than $50, or a rent greater than income. After re-weighting the renters for these deletions, these very aggressive adjustments reduce the number of "worst-case housing needs" by as much as 22 to 31 percent depending on the re-weighting method used.[7] The true magnitude of worst-case needs, however, is likely much closer to official estimates than these simulation results, because many of the deleted households were likely to have had severe cost burdens.

While further study of these issues and of the general approach to defining affordability[8] are clearly warranted, there is little doubt that housing affordability problems are widespread.

Household Income and Housing Affordability

Although concentrated among extremely low-income households, housing affordability problems reach across all but the highest income groups.

Most of the nation's very low-income households earn enough to cover utilities and other operating costs for many units, but not enough to support the cost of new construction or of the major repair or rehabilitation of distressed properties. With an ability to pay of about $675 for housing, low-income households have enough income to rent a modest but adequate home in most markets and, in some, to purchase an existing or new starter home with some effort and perhaps modest assistance. Meanwhile, except in high-cost markets, moderate-income households at or above the median income can generally find housing they can afford, although they often have only limited choice of type and location. In high-cost markets and among those earning near the bottom of the moderate-income range, many must spend more than they can readily afford or trade off neighborhood quality to lower their housing costs. Among those with high incomes, housing affordability problems are rare and choice of location is the broadest of all income groups.

The following table shows the monthly median housing costs for renters, owners, and then all households across the income spectrum (Fig. 5). Costs are based on incomes as reported by households.

Figure 5

Housing Costs Far Exceed Lower-Income Households' Ability to Pay

Households	Number (Millions)	Share (%)	Median Reported Income	Monthly Housing Costs Affordable	Monthly Housing Costs Actual	Cost as % of Income
Renters						
Extremely Low Income	8.5	25	$7,000	$175	$426	58
Very Low Income	6.2	18	$17,000	$425	$509	35
Low Income	7.3	21	$26,541	$664	$565	25
Moderate Income	6.6	19	$40,000	$1,000	$643	19
High Income	5.3	16	$68,000	$1,700	$736	12
All	34.0	100	$24,400	$610	$560	25
Owners						
Extremely Low Income	6.4	9	$6,500	$163	$300	50
Very Low Income	7.1	10	$15,613	$390	$324	25
Low Income	10.7	16	$27,000	$675	$453	21
Moderate Income	14.3	21	$41,200	$1,030	$633	17
High Income	30.3	44	$81,000	$2,025	$908	13
All	68.8	100	$45,400	$1,135	$617	17
All						
Extremely Low Income	14.9	15	$7,000	$175	$369	54
Very Low Income	13.3	13	$16,000	$400	$426	31
Low Income	18.0	18	$27,000	$675	$520	23
Moderate Income	20.9	20	$40,050	$1,001	$637	18
High Income	35.6	35	$79,000	$1,975	$865	13
All	102.7	100	$36,000	$900	$585	19

Source: HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

The Burden on Working Families

Working full-time does not guarantee immunity from acute housing affordability problems. Of the 11.3 million lower-income households with severe housing affordability problems in 1999, nearly one-quarter had earnings at least equivalent to full-time work at the minimum wage ($10,712 annually). To meet the needs of employers, however, many jobs are seasonal, temporary, or part-time so that not all employment-seekers are able to find year-round, full-time work. As a result, another 13 percent of low-income households with severe housing affordability problems were under-employed but still earning at least half of the minimum wage equivalent.

Moreover, many families with earnings significantly higher than the full-time, minimum wage equivalent also face moderate and severe housing affordability problems. Consider household heads working in retail sales (with a median income of $15,940), licensed nursing ($27,850), or law enforcement ($37,560).[9] Among the 11.8 million households with earnings between the median for retail sales workers and the median for licensed nurses, fully 34 percent had moderate housing cost burdens, and 10 percent had severe problems. Among the 11.4 million with earnings between the medians for licensed nurses and law enforcement, 19 percent had moderate problems, and 5 percent had severe problems.

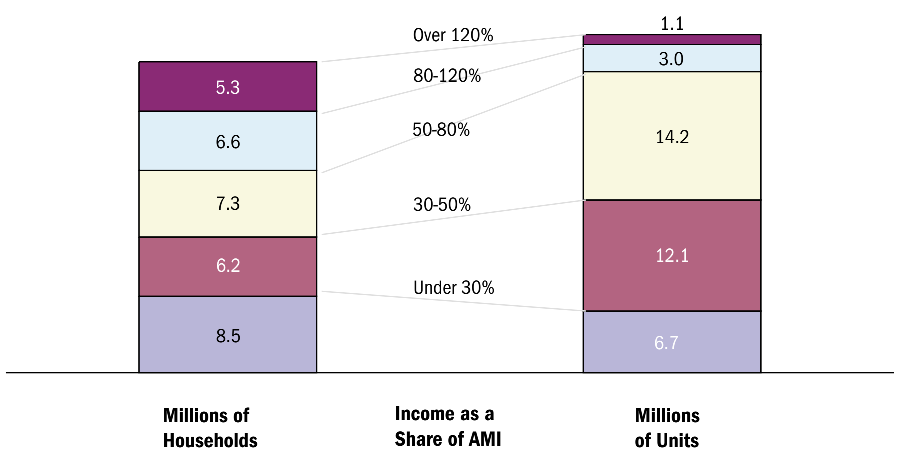
The Shrinking Rental Supply

Comparisons of renter households by income and the stock of units they can afford (at 30 percent of income) show a critical shortage of affordable apartments for extremely low-income households. National figures, however, mask wide variations in affordability both within and across metropolitan areas. In addition, a substantial portion of the rental housing that is affordable to lower-income households is old and located in neighborhoods with little access to jobs or adequate facilities and services. Making matters worse, higher-income households outbid lower-income households for rental units in an effort to limit their housing expenses, sharply reducing the number of affordable units for others.[10]

Despite the limitations of national comparisons, though, the aggregate numbers do reveal quite starkly the mismatch between the supply of and the demand for housing affordable to extremely low-income households. Only 6.7 million units have costs in the range that the nation's 8.5 million ELI renter households can afford to pay (Fig. 6). In addition, most ELI households tend to have incomes well below the top of the ELI income range, while most of the units, unless subsidized, have costs at the upper end of the range. The key point, however, is that even if all the units in the range were appropriately located, the right size, of good quality, and available, there would still be a shortage of 1.8 million units affordable to ELI households.

Figure 6

The Affordability Squeeze from the Supply-Demand Gap Primarily Affects Extremely Low-Income Households



Source: HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

The pressures on the affordable rental stock will only increase as the number of households headed by persons under age 25 and over age 65 gradually rises over the next 10 years, and then sharply thereafter. Since both groups tend to have relatively low incomes, their growing numbers will add even more to the demand for affordable rental housing.

No single tool or approach can solve the related problems of housing affordability and lack of supply. Where the stock of affordable rentals is adequate and available, vouchers can effectively assist families with incomes too low to pay the costs of providing and operating rental housing. But vouchers alone will not be enough in housing markets where the supply is inadequate or to provide housing opportunities in areas with fast-growing employment. Addressing this problem will require concerted efforts both to expand the supply of rental housing and to preserve the existing stock of subsidized and unsubsidized low-cost housing.

In the course of its deliberations, the Millennial Housing Commission considered the level of production that might be needed to make a substantial impact on the gap between the number of ELI households and the supply of affordable housing available to them. The addition of 150,000 units annually would make substantial progress toward meeting the housing needs of ELI households, but it would take annual production of more than 250,000 units for more than 20 years to close the gap.[11]

Affordability and Supply Trends

Given the favorable economic conditions of the 1990s, it is perhaps surprising that housing affordability problems stand at record levels for owners and near-record levels for renters. One might have expected that unusually strong income gains among low-income households, coupled with unusually slow growth in rents, would have led to a sharp reduction in the number of renters with severe affordability problems, but it did not. Similarly, one might have expected that the combination of rising incomes, markedly lower mortgage interest rates, and strong mortgage refinancings would have reduced the number of owners with severe housing affordability problems, but it did not.

The number of ELI renters with severe problems edged slightly higher between 1985 and 1999, although the share with these problems was flat. Among VLI renters, the share fell as many families made the move to homeownership, but the absolute number with severe problems remained flat. Meanwhile, both the number and share of ELI homeowners with severe housing affordability problems rose sharply as house price increases outdistanced income growth and the supply of homes available for sale shifted toward the high end.

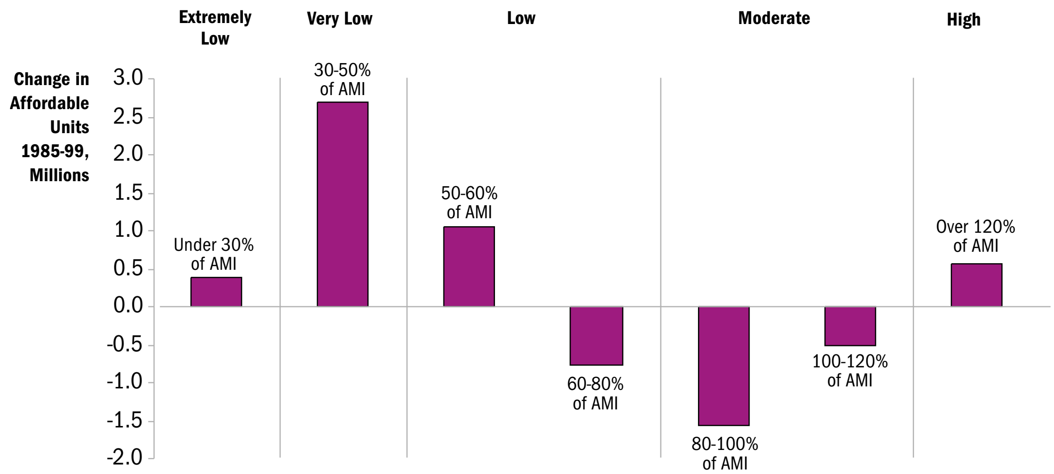
Changes in the supply of affordable rental housing are more complicated to interpret. There are two ways of looking at these trends. One is to consider what happened to the number of units renting at inflation-adjusted rent levels in each local market. This approach shows significant losses of the lowest-cost stock between 1985 and 1999.

The alternative approach considers how many affordable rental units were lost or gained over the period by adjusting income limits for both general price inflation *and* real income growth. This calculation takes into account how rising incomes redefine the rents considered affordable at each income level. Put another way, it accounts for the fact that, as incomes rise, rents affordable to each income class also rise. This approach thus gives a clearer picture of which rentals are truly affordable (using the 30-percent-of-income standard) to households with incomes at the upper limit of each income category at each point in time.

Use of this method reveals that the number of units affordable to households in the extremely low- and very low-income ranges increased as a result of rising incomes. But the number of units affordable to those with incomes between 60 percent and 120 percent of area medians fell sharply (Fig. 7).

Figure 7

Affordability Pressures Are Mounting as the Moderate-Income Rental Supply Plummets



Note: HUD income limits are adjusted for inflation and real income growth for both 1985 and 1999.
Source: Appendix 1, Table 2.

It would be incorrect to conclude from this analysis that there is no need to add directly to the stock of rentals affordable to ELI households. After adjusting for income growth, the supply of units affordable to such households is actually growing, but the existing gap between the number of ELI renter households and units in their affordable range reinforces the need for production. Even more important, a closer look at the rentals that are affordable *and* available to ELI households reveals that the supply remained dead flat *despite* the growth in number of units affordable to them. Apparently, the drop in the number of affordable rentals in the middle-income ranges led to increasing numbers of other renters occupying units affordable to ELI households.

This result underscores the importance of producing many more units for working families with incomes between 60 percent and 120 percent of area medians. These units are disappearing at an alarming pace. As a result, a potentially important source of rentals that might later become available to lower affordable ranges is being lost.

In addition, rental housing production has tilted toward units affordable only to the upper reaches of the income distribution. In 2000, only 13 percent of all completed two-bedroom apartments were affordable to renters earning the median income in that year. Only about one-third of completed two-bedroom apartments rented for less than $750.[12] This largely reflects the fact that the private sector cannot produce apartments in most areas that are affordable to households with incomes under 70 percent of area median (and sometimes even higher) without a subsidy.[13]

It is clear that the nation's housing affordability problems have not retreated, even under the unusually favorable conditions of the 1990s and current levels of government aid. The federal government must therefore expand the resources and tools available to stimulate production of units both for extremely low-income households, where the greatest needs exist, and at the low- and moderate-income levels, where losses of affordable units are increasing the pressures on working families.

Constraints on Production and Preservation

Several factors deter developers from producing affordable housing, particularly affordable multifamily housing. These obstacles include a lack of appropriate financing and the imposition of development controls. High development costs, reflecting stricter standards of construction and constraints on land supply, also play a role.

Inadequate financing for housing development. Builders of multifamily rental housing want financing with certain characteristics (such as early interest-rate lock-in, long amortization periods, and non-recourse development and construction financing) to limit their risk and enhance project feasibility.[14] Developments involving government subsidies entail added risks—appropriations risk (that the flow of necessary subsidies will be interrupted), operating risk (that restrictions on rents and rent increases will be too great to cover operating cost increases), and contract risk (that government will fail to honor original contractual agreements). FHA is the major insurer of capital on the terms that multifamily developers need and want, but limitations on credit subsidies and costs, as well as on processing capacity, constrain FHA's ability to support multifamily housing production.

The lack of a secondary market for development and construction loans also inhibits lending for both single-family and multifamily housing. Lenders hold these loans in portfolio, which means that costs are pegged to local markets. As a result, the loans carry interest rates with large spreads over comparable Treasury securities and are subject to credit crunches when concerns about credit quality drive lenders out of the market. These disruptions add to development costs. Small multifamily properties (containing 5 to 49 units), in particular, lack access to efficient secondary markets. These small properties accounted for 37 percent of all rentals in 1999 and are most often located in cities.[15] The limited availability of financing is significant for lower-income renters because these older, smaller properties are frequently more affordable than other structure types.[16]

Development controls. Zoning rules that sharply restrict or preclude development of multifamily and manufactured housing in some jurisdictions—as well as factors that add to land, construction, and infrastructure costs—also deter affordable housing development. For example, the capitalization into land values of superior job accessibility, public services, or other amenities places the cost of housing out of reach for lower-income families.

In addition, many communities impose impact fees and exactions on developments to cover the marginal costs of providing infrastructure and public services to new residential developments.[17] Other communities choose to lower public infrastructure costs by zoning for residential lots large enough to provide safely for private wells and septic systems, and by exacting land for parks, roads, and community facilities. At the same time, local electorates can resort to the ballot box to control the pace and direction of residential development. Although guided by other important public policy objectives, all these actions add costs[18] and raise barriers to both market-rate and low-income rental housing production.

Impediments to preservation. Complementing the importance of additional multifamily production is the necessity of preserving the existing stock of affordable housing. In 1995, nearly one-quarter of privately owned, federally assisted housing units were the unintended victims of programs that grossly under-budgeted for operations, maintenance, and renovations.[19] In addition, HUD set rent increases rather than allowing the market to do so and built in disincentives (such as limits on profits) for owners to maintain their properties.[20] For public housing, the culprits were policies that limited initial construction quality, local policies that funneled public housing to distressed markets, and, most importantly, insufficient appropriations for operating costs and modernization. Fixing the problems of these publicly and privately owned distressed properties will take additional federal investment, since the properties lack the cash flow to address their own problems.

Impediments to preservation include federal tax policies that leave many owners with liabilities upon sale that exceed the property's value after paying off the mortgage, and codes that are oriented toward new construction and thus deter moderate rehabilitation. Also important is the inadequacy of government subsidies necessary to cover the gap between what poor tenants can pay and the cost of operating rental housing.

Persistent Homeownership Gaps

While most Americans aspire to homeownership, many face formidable barriers to achieving their goal. These obstacles include the high cost of housing generally, the costs specifically associated with buying a home, the underwriting standards applied by mortgage lenders, and the cost and availability of mortgage credit.

Owning a home provides many unique benefits and is an important step up the ladder of economic opportunity. Ownership creates greater security of tenure, greater control over one's own home environment, and opportunities to build equity while locking in current costs with fixed-rate loans. Homeownership also helps stabilize communities by increasing the number of resident property owners who care about the daily quality of neighborhood life. Helping those willing and able to own homes to overcome the obstacles thus remains a significant national priority.

After a period of stagnation in the 1980s, evident progress was made in reaching out to low-income and minority homebuyers in the 1990s. Between 1994 and 2000, the number of lower-income homeowners increased by about 2.5 million, African-American owners by about 1.2 million, and Hispanic owners by about 1.2 million.[21]

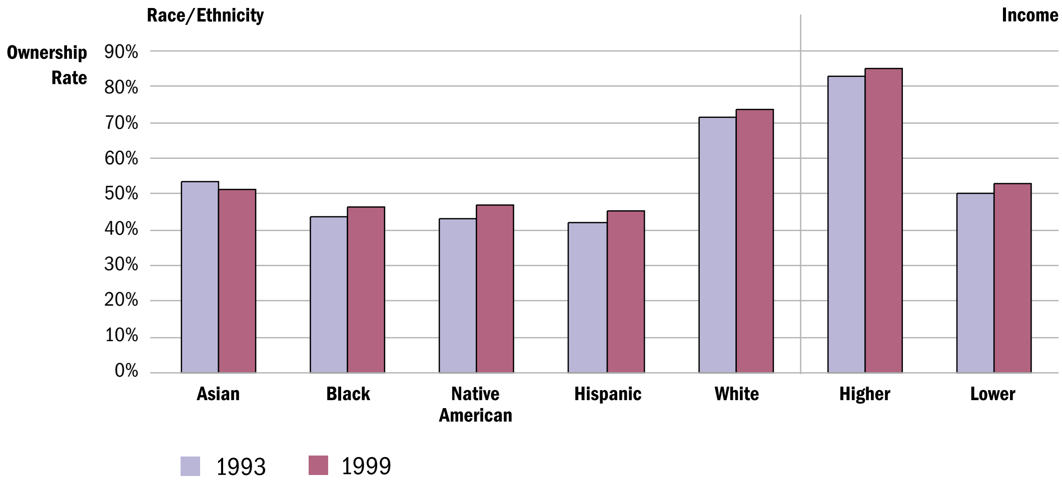
Because the largest single constraint on lower-income borrowers is lack of savings,[22] the dramatic reductions in downpayment requirements opened the doors to homebuying for many. In 1990, only 3 percent of all loans were made with downpayments of 5 percent or less. By 2000, that share had risen to 16 percent.[23]

Introduction of new risk management tools enabled lenders to relax underwriting standards and extend credit to low-downpayment borrowers. These tools also revealed that credit could be extended at higher housing-debt-to-income ratios than originally thought, provided borrowers have strong credit histories as measured by commercially available credit scores. Furthermore, the expanded use of automated underwriting systems lowered housing finance charges and removed individual discretion (and bias) from loan approvals. Finally, heightened regulatory pressures on Fannie Mae, Freddie Mac, banks, and thrifts to boost their purchases of loans to lower-income borrowers led to expanded marketing and outreach.

Even with all of these innovations, though, the homeownership rates of low-income families and minorities still lag those of higher-income families and non-Hispanic whites by large margins. As of 1999, the gap between black and white homeownership rates stood at 27.2 percentage points, the gap between Hispanic and white homeownership rates at 28.6, and the gap between lower-income (defined as under 80 percent of AMI) and high-income (defined as greater than 120 percent of AMI) rates at 32.3 percentage points (Fig. 8).[24] A slim majority of lower-income households owns homes.

Figure 8

Despite Recent Gains, Minority and Low-Income Homeownership Rates Still Lag



Source: U.S. Bureau of the Census, Current Population Survey, 1993 and 1999.

Differences in the average incomes and ages between minorities and whites explain some, but not all, of these gaps. Even if minorities owned at the same rate that whites of comparable ages and incomes do, the minority homeownership rate overall would still fall more than about 12 percentage points below that of whites.[25]

Lagging minority homeownership rates are a serious concern for the future. Minority households are expected to account for fully two-thirds of household growth over the coming decade. Improving the ability of such households to make the transition to homeownership will be an especially important test of the nation's capacity to create economic opportunity for minorities and immigrants and to build strong, stable communities.

The Federal Role in Housing

The federal government currently employs a range of programs, tools, and agencies in its efforts to address the nation's housing and community development challenges. These programs are described briefly below, with more detail presented in Appendix 3 of this report. The history of government involvement in the housing sector provides useful background and context for the Millennial Housing Commission's recommendations to Congress.

Historical Overview

The federal government first intervened in the housing market during the 1930s in an attempt to restore liquidity and stability to the financial system and to generate construction jobs. Creation of the Federal Home Loan Bank System and the Federal Housing Administration (FHA) was not intended to assist the poor, but rather to aid lending institutions and help lift the U.S. economy out of the Depression.

In 1937, the U.S. Housing Act created the public housing program, authorizing local housing authorities to build units financed through long-term bonds to serve poor families. In 1938, the federal government chartered the first government-sponsored enterprise (GSE), which marked the beginning of a secondary mortgage market.

After World War II, the urgent housing shortage faced by returning service men and women spurred creation of Veterans Administration guarantees on mortgage loans and increased FHA activity in insuring home mortgages. The Housing Act of 1949, enacted with strong bipartisan support, established the goal of "a decent home and a suitable living environment for every American family." The act also created the Urban Renewal (then called Urban Redevelopment) program, intended to improve communities by giving grants to localities to eliminate slums and blight by substantially reducing land acquisition costs. In addition, the act authorized funding for another 810,000 units of public housing, and took a first step toward addressing the housing needs of rural Americans by authorizing the U.S. Department of Agriculture to make loans and extend related assistance to low-income farmers.

During the 1950s, communities used Urban Renewal to fund demolition and redevelopment. The Housing Act of 1954 instituted a "workable program" requirement under which localities had to submit a plan for redevelopment—the first example of comprehensive planning being required for federal funding, a standard that continues to this day. The 1950s also saw development of a special program for nonprofit owners to provide housing for elderly or handicapped tenants, as well as continued growth in federal involvement in housing finance as the FHA became more active in insuring multifamily mortgages.

During the 1960s, the FHA introduced a wave of new housing finance programs to subsidize production of multifamily housing for low- and moderate-income families. Below-market interest rate loans and direct subsidies of various sorts, along with new tax write-offs, were added to spur private sector participation. While limiting owners' returns over the life of the program, the programs allowed owners to convert the properties to market rate rentals after 20 years. This program structure turned out to have perverse effects: at the end of the 20 years, the government lost the best-run and most attractive properties in good locations, and was left with the poorly located and managed properties that did not command high enough rents to cover the costs of capital preservation.

In 1965, the U.S. Department of Housing and Community Development (HUD) was created as a cabinet-level department charged with overseeing the nation's housing and community development programs. The 1960s also marked the launch of a new approach—the ability of public housing authorities to rent privately owned units for their tenants. This precursor to housing certificates and vouchers enabled low-income families to rent privately owned units.

By 1969, some of public housing's poorest tenants were paying as much as three-fourths of their incomes for rent, and payments equal to one-half of gross income were common.[1] A series of amendments then eliminated PHAs' ability to set minimum rent levels and instead capped rents at 25 percent of tenant income. Congress addressed the resulting loss in PHA operating income in 1970 by introducing subsidies intended to cover the shortfall between rental income and operating expenses. Later, in the Omnibus Budget Reconciliation Act of 1981, Congress raised the minimum rents on public housing from 25 percent to 30 percent of income in an attempt to boost PHA income. In addition, HUD issued regulations pursuant to previously enacted legislation giving preference to families with severe housing problems.

The Housing and Community Development Act of 1974 brought about two major changes in housing programs. First, it consolidated seven categorical grant programs to localities into the Community Development Block Grant (CDBG) program, which continues to fund a broad array of community development initiatives. This program provided for local flexibility in how best to engage in community development, but required submission to HUD of a formal planning tool called the "Housing Assistance Plan." Second, the 1974 act amended the U.S. Housing Act of 1937 to create the Section 8 program, under which the subsidy covered the difference between a fixed portion of tenant income and the "fair market rent" for the unit, as defined by HUD. The program was primarily used by, but not limited to, the private sector. Section 8 was designed to give localities the flexibility to use the funds for new construction, substantial rehabilitation, or tenant-based assistance for occupancy of existing rental units. Long-term (20- to 40-year) subsidy contracts for Section 8 new construction and moderate rehabilitation facilitated the private financing of such developments.

In the early 1980s, additional tax incentives made development of affordable rental housing even more profitable. The Tax Reform Act of 1986 then repealed accelerated depreciation and use of depreciation deductions to offset other ordinary income, precipitating a sharp drop in multifamily production. In addition, the act placed a cap for the first time on state authority to issue tax-exempt bonds for multifamily housing and imposed income limits on eligible households. At the same time, though, the act created the Low Income Housing Tax Credit (LIHTC) program, providing private-sector incentives for the development of rental housing for lower-income households. The McKinney-Vento Homeless Assistance Act of 1987 marked the first federal legislation to address homelessness by providing funding for shelters and supportive housing.

With the 1990s came introduction of the HOME Investment Partnerships (HOME) program, a block grant used by state and local governments to address affordable housing needs. Based on a series of targeting standards, data on housing needs, and activities identified in a Comprehensive Housing Affordability Strategy (later merged into what is now the Consolidated Plan, or ConPlan), recipient jurisdictions could develop their own programs and activities to meet affordable rental or homeownership housing needs. The 1990s also marked the establishment of separate allocations for elderly and handicapped persons, the introduction of funding for the revitalization of severely distressed public housing (HOPE VI), and block grants for Native American housing.

Programs Active Today

Today, the LIHTC and HOME programs support multifamily rental housing production. The federal government also promotes multifamily rental production by permitting issuance of tax-exempt bonds, through FHA mortgage insurance products, and, in rural areas, through direct and guaranteed loans provided through the Rural Housing Service (RHS)—formerly the Farmers Home Administration—of the U.S. Department of Agriculture.

Public housing is still a major source of affordable units for low-income households. The existence of large, generally high-rise, urban public housing developments—many of which are now being replaced by mixed-income developments under the HOPE VI program—has generally obscured the fact that most public housing is in smaller developments that do not share the problems generally associated with the high-rise, high-density units.

All told, the federal government subsidizes nearly 1.3 million publicly owned housing units and just over 1.9 million privately owned units. In addition, the federal housing choice voucher program provides rental subsidies to nearly 1.6 million lower-income households, enabling them to rent apartments from private landlords who are willing to accept voucher-holding tenants.

On the homeownership side, the federal government reduces costs to owners through mortgage interest and real estate tax deductions, tax-exempt bond financed mortgages for low-income first-time homebuyers, FHA and RHS mortgage insurance for low-downpayment loans with liberal underwriting, Veterans Administration loan guarantees, and RHS below-market interest rate loans to low-income rural homebuyers. The government also supports homeownership through mortgage market interventions via the GSEs—the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Bank System—all of which help to leverage and maintain a steady flow of mortgage funds to primary-market lenders.

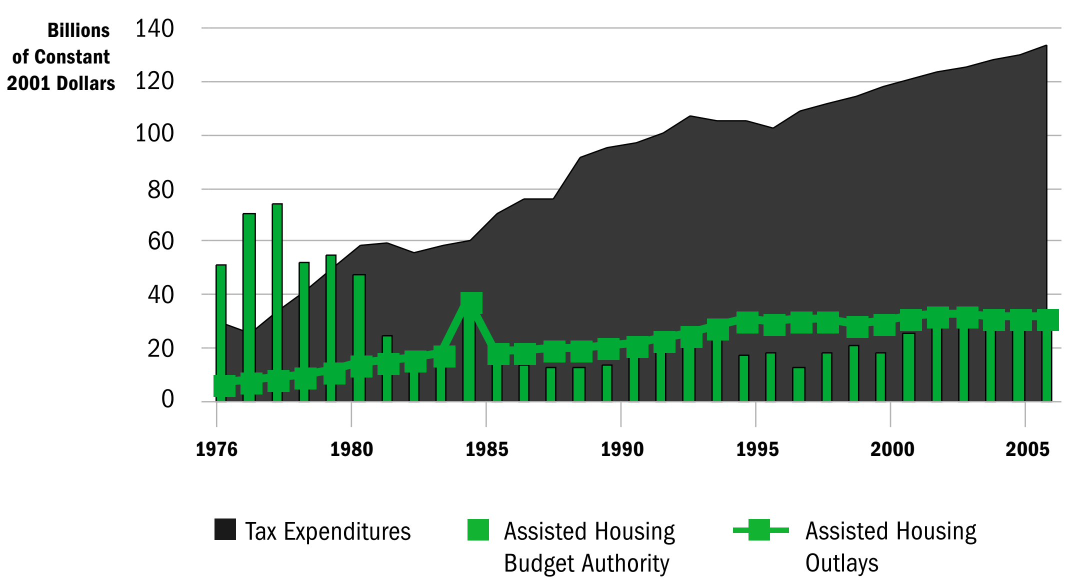
Some of the same tools used to stimulate housing production and preservation are used to foster community development. State credit agencies (usually state housing finance agencies), which administer the LIHTC, typically award points in competitive applications to projects that support broader community development goals. Additional tools include the Community Development Block Grant (CDBG), which may be used for neighborhood redevelopment, economic development, and community services, and HOPE VI grants for the comprehensive redevelopment of public housing.

The following figures provide a snapshot of current federal spending on housing.

In 2001, tax incentives totaling $121.2 billion made up the majority of federal housing support. The Joint Committee on Taxation estimates the FY 2001 value of the mortgage interest deduction alone at $64.5 billion, benefiting 32.1 million taxpayers.[2] By comparison, direct spending on housing assistance totals $34.9 billion (Fig. 9).

Figure 9

Rising Tax Expenditures Far Outweigh Direct Spending on Housing Assistance

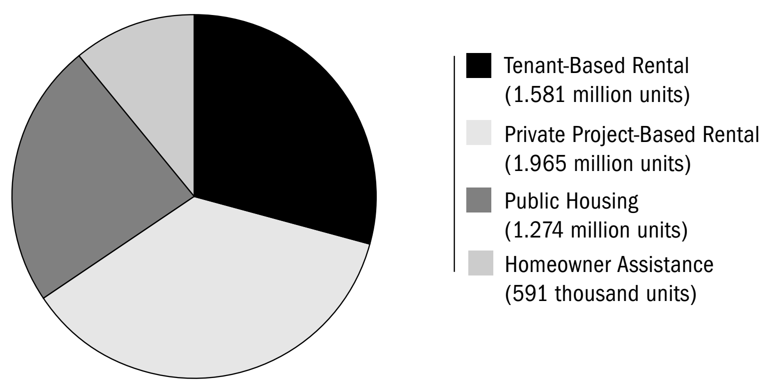


Source: National Low Income Housing Coalition, *Changing Priorities: The Federal Budget and Housing Assistance, 1996-2006* (Washington, D.C.: NLIHC, 2001).

Almost all direct federal spending is targeted at renters (Fig. 10). Today, the stock of directly subsidized rental housing receives a combination of project-based and tenant-based assistance. Federal resources are spent both on producing new affordable housing and on paying for the maintenance of housing built under programs that have since been discontinued.

Figure 10

Direct Assistance Primarily Targets Renters and Rental Housing

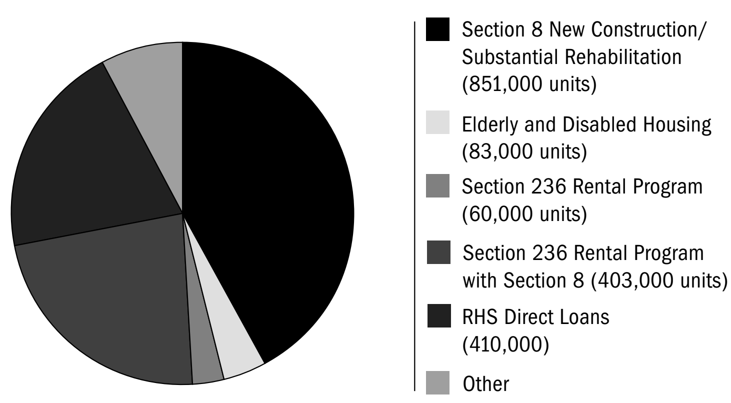


Source: Appendix 1, Table 3.

The inventory of privately owned subsidized properties consists of units produced under a variety of programs (Fig. 11). Today, however, none of these programs still produces new units except for the elderly (Section 202) and disabled housing programs (Section 811), which provide capital grants and rental assistance for housing built by nonprofit sponsors, and the Section 515 program, which produces housing in rural areas.

Figure 11

The Inventory of Privately Owned Subsidized Properties Totals Just Under Two Million Units



Source: Appendix 1, Table 3. Note: "Other" includes Section 221(d)(3) BMIR, Rent Supplement, Section 8 PD, and remaining Section 8 LMSA units. Units are adjusted to account for overlap among units using more than one program.

Lessons Learned

In developing new policy options, the Millennial Housing Commission looked to the lessons of history as well as to the testimony and ideas submitted during the course of its deliberations. The Commission sought to model its recommendations on measures that have worked well and to avoid the repetition of past mistakes—many of which were the unintended consequence of program implementation rather than of program design.

The lessons learned from the 70-year history of federal housing programs are many and varied. Those most influential in helping the Millennial Housing Commission craft its recommendations include:

1. Affordable housing developments cannot be isolated from the broader community in which they are located, and must provide access to decent schools, job opportunities, and transportation.

2. Decisions about the location and management of affordable housing are best made by state or local governments, rather than the federal government.

3. The private sector needs the proper incentives to be an effective partner in the federal government's efforts to address the nation's housing challenges.

4. When resources are limited, there are difficult tradeoffs between making rents affordable to the poorest tenants and ensuring that enough income flows into a property to cover the repairs necessary to sustain the structure's useful life.

The Commission's recommended new programs and suggested reforms for current programs incorporate all of these important lessons.

Principal Recommendations to Congress: A Framework for Change

The Millennial Housing Commission's vision can be stated quite simply:

to produce and preserve more sustainable, affordable housing in healthy communities to help American families progress up the ladder of economic opportunity.

The Commission's principal recommendations to Congress for achieving this vision are divided into three categories: new tools, major reforms of existing programs, and streamlining of existing programs. The four policy principles of strengthening communities, devolving decision-making, involving the private sector, and ensuring sustainability inform all of the recommendations. The Commissioners believe that these principles will make housing programs work more effectively to attain the goal of more affordable housing in healthy communities, building on what works now to meet bold housing goals tomorrow.

1. Strengthen communities.

The Millennial Housing Commission believes housing policy must foster healthy neighborhoods that form larger communities and function well for residents of all incomes. Housing is, however, only one part of the equation. Good schools, job opportunities, and public safety are also essential to creating healthy communities.

Distressed inner cites, declining inner-ring suburbs, and booming suburban areas can all benefit from affordable housing that is part of a broader community development plan. In inner cities, safe and well-maintained housing anchors communities, often attracting businesses and additional economic development. In declining, inner-ring neighborhoods, the addition of affordable and appealing housing units can slow—or even reverse—population losses. In high-growth suburban areas, the presence of affordable housing contributes to community by enabling key workers—such as teachers, firefighters, and police—to live near their jobs. Affordable housing also expands the pool of labor to fill lower-wage service jobs, reduces individual commuting times and overall traffic congestion, and allows workers to spend their wages locally.

People should have the choice to settle in healthy, sustainable communities in any location. To make that possible, the federal government must take the lead in offering states and localities the tools and incentives to encourage development not only of affordable housing, but also of thriving mixed-income communities.

2. Devolve decision-making to states and local governments, but within a framework of federal standards and performance objectives.

While all three levels of government are important players in the housing delivery system, the Commission believes that states—working closely with localities—can best address certain key challenges. It is a major thrust of the MHC's recommendations that Congress pay special attention to assigning appropriate roles and responsibilities to each level of government.

- **Federal role.** The federal government should set overall affordable housing goals, establish performance measures, and provide the resources to address urgent housing needs. It should also ensure those resources are fairly and effectively delivered. To do so, HUD must establish broad performance requirements for delivery of housing assistance in both entitlement programs (such as HOME and CDBG) and competitive programs (such as homeless assistance and HOPE VI). While specifying acceptable outcomes, HUD should not be involved unnecessarily in procedural requirements, other than those necessary to assure the objectives of programs are met.

- **State role.** Housing needs do not exist in a vacuum, but rather in the broader context of job and commercial development, smart growth initiatives, health care delivery challenges, and other community development issues that require statewide leadership, planning, and administration. States should therefore administer and allocate a portion of the funds because they can coordinate housing resources with the other federal funding streams they already manage, and they can carry out strategies that extend across jurisdictions. States may wish to delegate some of these functions to local governments, as some already do.

- **Local role.** While it is the states' job to address regional issues and provide necessary resources, local governments are in the best position to assess and address specific affordable housing needs. Local governments have a key role to play in neighborhood revitalization, with affordable housing one of their most effective tools. The MHC recommends that federal programs that provide funds directly to localities (such as HOME and CDBG) be simplified so that they can be combined more easily. Local jurisdictions should also be involved in state plans to target any new federal initiatives for housing and community development.

3. Provide the private sector with effective incentives to help produce and preserve affordable housing.

Congress charged the Commission with enhancing the role of the private sector. The MHC took this mandate seriously. Effective delivery of affordable housing relies on enabling the public sector, for-profit businesses, and nonprofit organizations to do what each does best. Indeed, one of the most cost-effective ways to produce more affordable units is to attract the capital and skills of the private sector to this activity.

For-profit businesses perform all the activities—land acquisition, design, finance, construction, and property management—necessary to produce new affordable units. With the proper incentives and sufficient public subsidies, all that private access to capital, efficiency, and entrepreneurial talent can be brought to bear on the affordable housing shortage. Competition and market incentives can also play a valuable role in making service delivery efficient and in reducing costs to consumers.

4. Design programs to sustain the stock of affordable housing over the long term.

Federal investment in the affordable inventory must be carefully protected. Ensuring the adequate maintenance and long-term viability of both the new and existing affordable housing stock should therefore be one of the most important priorities of U.S. housing policy.

Allowing buildings to fall into disrepair is much more costly in the long run than planning and funding regular maintenance and replacement. Deferred maintenance adds to capital costs over time—each dollar spent on maintenance now is worth many more dollars spent on major renovations later. Housing programs must ensure that resources are available to keep affordable housing in good shape over the long term.

All property, whether affordable or not, requires ongoing repairs and capital improvements. Roofing, boilers, and other major systems have limited useful lives. It is a housing policy failure when money is not budgeted to replace major systems in buildings financed and subsidized by the federal government.

Ensuring the long-term sustainability of new affordable units requires a recognition that more durable materials cost more and that sufficient reserves need to be included in the underwriting. At the same time, owners must receive a return on capital that provides sufficient incentive to keep their properties in good repair.

The Commission's principal recommendations are presented below.

New Tools

The Commission proposes several new tools, all of which would be administered by states working with localities. The tools are targeted to unmet need and involve private-sector incentives as appropriate.

Allocate a flexible new tax credit to stimulate production of affordable properties suitable for homeownership.

The federal tax code provides the largest and most often-cited incentive for families to become homeowners—the deductibility of mortgage interest payments and real estate taxes from federal income taxes. For higher-income taxpayers who itemize their deductions, this provision reduces annual tax liabilities and thereby increases disposable income. Most homeowners also benefit from the capital gains exclusion when they sell their principal residences.

Low-income homeowners, however, enjoy few of these tax-related benefits. Because they have smaller mortgages and lower-value properties, these homeowners do not have itemized deductions that exceed the standard deduction. In fact, about 90 percent of the total benefits of the mortgage interest deduction accrue to homeowners with more than $40,000 in income.[1]

To help lift low-income and minority homeownership rates, the MHC recommends creation of a new homeownership tax credit, to be allocated to state housing finance agencies. HFAs would have the flexibility to use the credit to build supply in tighter markets, to stimulate demand where markets are relatively weak, or both.

Promoting Production and Preservation

The state HFA (or a local agency if a state decides to delegate) could choose to use the credit to promote production or rehabilitation of homes in eligible census tracts where production/rehabilitation costs exceed the market value of the properties. Developers would compete for the tax credits and could sell them to investors. Proceeds would cover the difference between the cost of production and the fair market value of the property, up to 50 percent of total development costs. (In most cases, considerably less than 50 percent would be necessary.) Scrutiny of total development costs would be an important element of this program, as would careful appraisals where no comparable sales exist. The Commission views this as an important community development tool.

Achieving Affordability

The state HFA could also choose to use the credit to achieve affordability for low-income homebuyers by tackling the primary barriers to homebuying: insufficient income to support monthly payments and insufficient savings to cover downpayment and closing costs. While the availability of low-downpayment first mortgages has increased, closing costs are still a major hurdle to homeownership. In addition, low-downpayment mortgages do not eliminate income constraints, because borrowers typically pay higher interest rates and mortgage insurance on their larger loan balances.

States could use the new homeownership tax credit to address both income and wealth constraints by auctioning off credits to lenders in return for commitments to reduce borrowing costs, downpayment requirements, or both. Lenders—including financial institutions, community development corporations, and community development financial institutions—would bid for the credits from state housing finance agencies. Qualified lenders would underwrite loans within clear guidelines for minimum and maximum ratios, as well as for home purchase price and prepayment expectations.

The credit would be applied against the borrower's mortgage in the form of prepaid points, below-market interest rates, or other subsidized mortgage terms. Borrowers could apply points toward downpayment or closing costs, or buy down the interest rate to reduce monthly outlays.

Only first-time buyers with incomes below 80 percent of area median would be eligible. Congress may wish to encourage states to adopt a requirement that such buyers take homeownership training courses in order to qualify for single-family housing assisted with this credit. Recent research shows that such counseling has a demonstrable impact on loan performance.[2]

Buyers would be prohibited from prepaying the tax-credit loans for five years except in the case of a sale, and loans would not be assumable. Buyers of the production credit would be required to sell to qualified owner-occupant buyers if the unit were sold within five years of project completion. Recapture provisions, such as those currently used in the HOME program, would apply.

The advantage of the homeownership tax credit over direct subsidy programs is that it devolves authority to states and relies on private-sector partners to deliver allocated resources. No matter how agencies choose to use the credit, however, the Commission believes it will be a valuable community development resource that enhances the overall stability of neighborhoods.

While a homeownership tax credit is an important additional incentive to create more affordable housing, details of a new credit must be carefully crafted to avoid any adverse impact on the existing Low Income Housing Tax Credit for rental housing.

Enact exit tax relief to encourage preservation.

This is a two-part recommendation that first explains the importance of preservation generally, and then outlines a critical new tool to promote the immediate preservation of at-risk properties.

The Case for Preservation

Broadly speaking, privately owned, multifamily rental units available to low-income families fall into two categories: (1) federally assisted units, in which an owner receives some sort of public, project-based subsidy in exchange for a contractual obligation to maintain affordability for low-income renters, and (2) conventionally financed units, which may be available to low-income renters in some markets but where the owner is without a contractual obligation to maintain affordable rents. Many of the low-income families who occupy conventionally financed units pay more than 50 percent of their incomes in rent.

In 1999, the federally assisted inventory provided one in ten rental units affordable to low-income renter households. For a variety of reasons, units are being lost from both inventories. As part of its strategy to address this crisis, the nation needs to preserve the federally assisted properties and to draw privately held, conventionally financed multifamily units into the long-term affordable stock, where possible.

Losses from the federally assisted inventory. The federally assisted stock generally consists of two types of units: those financed, beginning in the 1960s, with federally subsidized, 40-year mortgages; and those financed, beginning in the 1970s, through Housing Assistance Payment (HAP) contracts between owners and HUD. The HAP contract guaranteed owners a contract rent amount to make up the difference between tenant payments and the fair market rent. In both cases, owners were required to rent to eligible, low-income households for the period of time spelled out in the terms of the federally subsidized financing or contract.

Owners of units financed with mortgage subsidies were permitted, after 20 years, to prepay the remainder of their subsidized mortgages and end their obligation to maintain rents affordable to low-income households. For properties financed through HAP contracts, some contract periods have expired and some remain in effect. When HAP contracts expire, owners can either "opt out" of the program, taking their properties to higher, unregulated market rents, or they can choose to remain in the program. Owners then have the opportunity to enter into multiyear contracts that are, however, subject to annual appropriations.

In the early 1990s, substantial numbers of federally assisted units became vulnerable to prepayment or opt out in the midst of a strong real estate market. This confluence of circumstances brought about the most pressing crisis in the history of federal involvement in affordable housing. Where local markets supported an economic decision to do so and as their federal contracts expired, many private owners of assisted properties exercised their right to prepay their subsidized mortgage notes or opt out of their HAP contracts. As a result, many units were lost from the rent-restricted inventory.

The Commission notes that many of the properties eligible to leave the rent-restricted stock that were in a position to profit by exiting have already done so. Some properties that remain in the affordable inventory but are legally eligible to leave it will do so, as well. The owners of some properties that are economically marginal may prefer instead to transfer ownership to a new, mission-driven owner. In general, properties with lesser economic value are at risk of deterioration, and ultimately abandonment, unless they can be transferred to such entities.

For most of the federally assisted project-based inventory, the affordable use restrictions on the properties will eventually expire.[3] A portion of these properties are at risk of loss from the restricted stock because of local market conditions. For example, strong markets may increase the likelihood of opt out, while weak markets can contribute to further property deterioration. The Commission's proposed preservation tax incentive, described below, is intended to reduce the number of project-based units lost from the affordable stock by giving current owners an incentive to transfer ownership to new owners who commit to the long-term preservation of affordability.

Losses from the conventionally financed inventory. The conventional inventory is also a large source of affordable housing for low-income families. In fact, in 1999 more than 60 percent of units affordable to extremely low-income households and nearly 87 percent of units affordable to very low-income households were unassisted.[4] The loss of this stock has potentially dramatic consequences for such households. In tight housing markets and/or gentrifying areas, the risk of escalating unaffordability is real, since owners can increase rents as local market conditions warrant. The Commission cites the risk of rent escalation within the conventionally financed inventory as a compelling reason both to preserve as many privately held units as possible and to recognize the preservation of affordable housing as a critical public policy goal.

Preservation as a critical public policy goal. To avoid a repeat of the current preservation crisis, it is critical that the nation adopt a preservation philosophy to guide its housing policy going forward. Every newly produced building ultimately reaches the end of its useful life. Federal housing policy must anticipate and plan for this eventuality.

Moving forward into this new paradigm will require several changes to existing federal programs and standards, each aimed at embedding the following principles, among others, into the federal system:

- ***A new underwriting standard for long-term sustainability.*** All federal programs should embrace a new norm whereby rehabilitated buildings are underwritten to provide 30 years of affordability and newly constructed buildings are underwritten to provide 50 years of affordability. There must be one underwriting standard for each type of building that reflects its respective affordability period. This is a change from the existing system, in which two separate underwriting standards—one for financing and one for affordability restrictions—are in place.

  The best way to ensure a property's long-term physical and financial health is to maintain adequate reserves for replacement. The new underwriting standard must reflect a property's long-term capital needs. The Commission recommends that Congress undertake an analysis of the impediments to establishing and maintaining adequate replacement reserves, including the tax implications.

- ***Efficient use of federal resources, including built-in encouragement of private leverage of public capital.*** The federal system should encourage the use of mixed-income models, the pooling and leveraging of assets, and the creation of economies of scale to reward practitioners who help build efficiencies into the system. There should be built-in rewards and incentives for the quick and efficient use of capital to encourage preservation practitioners to compete favorably with market-rate, private-sector interests.

- ***Recognition of the unique nature and needs of entities committed to expanding the universe of affordable units through preservation.*** The current system forces preservation under an umbrella of affordable housing programs that are geared toward new production. Entities dedicated to preserving currently affordable units and acquiring and then preserving conventionally financed properties must be expressly recognized in U.S. housing policy and programs. The Commission recommends that such "preservation entities" be provided with the tools and resources they need to carry out their unique mission.

- ***Recognition of the broader benefits of preservation.*** U.S. housing policy must recognize that preservation is cheaper than new construction, that the rehabilitation and preservation of units returns the units to low-income families faster than new construction can provide such units, and that maintaining and renovating existing units combats blight and contributes to healthy communities.

The Case for Immediate Preservation via a Preservation Tax Incentive

While these principles must be woven into the overall system for long-term success, the need to preserve at-risk units is immediate and pressing. Because time is of the essence, any proposed tools or approaches that can quickly and efficiently preserve housing should receive heightened attention, support, and funding from the federal government. It is therefore critical that tools such as the proposed preservation tax incentive (PTI) be adopted and enacted as quickly as possible. The PTI would grant exit tax relief to multifamily owners who sell to a preservation entity.

For all of the reasons stated above, it is critical that all multifamily owners be eligible for exit tax relief. Since residents of federally assisted properties enjoy true affordability (paying no more than 30 percent of income in rent), federally assisted properties should receive highest priority for preservation using this proposed new tool.

Before 1986, the tax code included incentives to encourage limited partner investors to provide equity to multifamily developers in exchange for current tax savings (against then higher marginal rates). Investors were permitted to deduct from taxable income their share of the losses of the project partnership, including, importantly, depreciation expenses (a noncash item)—thereby reducing current income taxes payable. In later years of the partnership, when mortgage amortization exceeded depreciation expenses, the amount of that excess amortization would become taxable as ordinary income (so-called "phantom income"). The code essentially provided for a deferral of tax, and the value of that deferral constituted the investor's economic return.

Changes in the tax code in 1986 eliminated the ability of most investors to deduct losses generated by their properties from otherwise taxable income. When mortgage amortization began to exceed depreciation expenses (after 10 or 15 years) and properties still generated taxable phantom income—typically in amounts greater than cash flow—pre-1986 investors were deprived of their expected economic return. Investors found themselves with no deferral of tax, and the tax on phantom income in the later years of a partnership remained. Clearly, investor economic interest in such properties was substantially diminished and, as a consequence, necessary maintenance was in many cases reduced or eliminated. Properties with such a history are most likely to benefit from a preservation tax incentive.

Even if an investor is no longer interested in owning a property (from which s/he has gained no significant economic benefit since 1986 and will gain none in the future), the investor is discouraged from transferring the property, because s/he will typically have a negative tax basis (the amount by which accumulated depreciation exceeds mortgage amortization) and be subject to a tax on that negative basis (the "exit tax").

As an urgent first step in the nation's movement toward a preservation philosophy, described earlier, the Commission recommends that states be given the authority to allocate exit tax relief, via a preservation tax incentive, to stimulate the transfer of properties to preservation entities. Such relief would offset the investor's negative tax basis in the property, thereby eliminating a significant barrier to transfer.

Because current owners have options to eliminate or reduce their tax liabilities by holding and, in some cases refinancing, their properties, it is unclear how much tax revenue would be foregone with enactment of such relief. What is clear is that absent such relief, properties and tenants will continue to suffer the consequences of maintenance disincentives, and spillover effects will occur in some neighborhoods.

The MHC expects states to use this new tool to address identified need by encouraging private-sector owners of properties to transfer ownership to preservation entities. In the implementation of the recommendation, the Commission envisions different roles for different levels of government, as described below.

Implementation of the Preservation Tax Incentive

Federal role. The Commission recommends that Congress:

1. Specify the minimum required elements of transactions eligible for PTI. For example, Congress may wish to require that the transaction be governed by a "long-term affordable housing use agreement" that specifies ongoing affordability for a certain term. The Commission suggests a minimum use agreement of 30 years and the following affordability requirements:

- ***For assisted properties:*** The new owner (a preservation entity) must maintain existing federal subsidies. When the affordability period for the existing federal subsidy expires, the new owner may not opt out, must renew at least 50 percent of the federally subsidized units, and must also rent at least 20 percent of the units to households earning no more than 50 percent of AMI or 40 percent of the units to households earning no more than 60 percent of AMI.

- ***For unassisted properties:*** The new owner (a preservation entity) must make at least 20 percent of units affordable at 50 percent of AMI or 40 percent affordable to households earning 60 percent of AMI.

These minimums will ensure that tax credit and tax-exempt bond financed projects will be eligible for relief. They will bring dependable, long-term affordability and a measure of income-mixing to newly preserved buildings.

2. Establish penalties for noncompliance. The Commission suggests the penalty for nonprofits be loss of tax-exempt status; for-profits should pay a tax penalty.

3. Establish broad affordability parameters for newly affordable, preserved units. For example, Congress may wish to specify that a minimum percentage of newly affordable units be targeted to extremely low-income households.

4. Establish general, minimum threshold criteria for an entity to qualify as a preservation entity for purposes of exit tax relief transactions.

5. Clarify that use restrictions, affordability levels, and subsidies can be assumed by other qualified entities.

State role. As described below, states would determine which properties/owners are eligible for a preservation tax incentive. They would also establish specific criteria that define a "preservation entity" and a "preservation transaction":

- ***Criteria for eligible properties/sellers.*** The following types of properties would be eligible for relief: assisted properties with negative tax equity (i.e., properties that, if sold at fair market value, would generate net sales proceeds [over and above debt] insufficient to cover the owners' capital gains tax liabilities), positive-tax-equity assisted properties, negative-tax-equity unassisted properties, and unassisted properties with positive tax equity.

- ***Criteria for qualifying as a preservation entity.*** The state may, for example, require a preservation entity to demonstrate its previous commitment to affordable housing as well as the organizational and financial capability necessary for long-term, successful management of a mixed-income project. Furthermore, the state should require an entity seeking "preservation entity" status to demonstrate its independence from the seller or its affiliates.

- ***Criteria for preservation transactions.*** Such transactions will comply with any and all federal requirements and must meet additional state criteria, if applicable. In order to be eligible for exit tax relief under the PTI, the proposed transaction must be certified as economically viable. That is, the state must determine that the property, under the proposed underwriting, is capable of sustaining itself as affordable and structurally sound for the minimum period of 30 years.

States will also perform other functions. Specifically, they will:

1. Develop and maintain a list of qualified preservation entities.

2. Issue approval letters to sellers and purchasers who have proposed eligible transactions. The letters will set forth conditions that the transaction (as closed) must meet in order to maintain eligibility for relief.

3. Be responsible for assuring owner compliance with program requirements.

Illustrative Sample Mechanisms

A seller would establish entitlement to relief by working with the purchaser and the state HFA to have the state HFA approve the eligibility of the proposed transaction. The HFA's letter of approval would set forth the conditions to be met at the closing. After the transaction closed, the seller would certify to the HFA that the transaction closed in accordance with the conditions set forth in the HFA's approval letter. The seller would attach the HFA's approval letter and the seller's post-closing certification to the seller's federal income tax return as documentation of the seller's entitlement to exclude the gain due to the seller's negative capital account from federal taxable income. Tax would be paid on any consideration received over and above the mortgage amount.

The Commission acknowledges that this recommendation proposes a tax credit limited only by the aggregate negative tax basis of preservable affordable properties. In the event that Congress chooses to apply a different limit to the amount of credit made available, the Commission recommends two options:

- Extend eligibility first to HUD- and USDA-assisted properties, then to unassisted properties where housing choice vouchers are readily accepted, and then to other unassisted properties; or

- Cap the resource and allocate it to state housing finance agencies, allowing them the discretion to allocate relief to both assisted and unassisted properties, as needs warrant.

Provide capital subsidies for the production of units for occupancy by extremely low-income households.

The most serious housing problem in America is the mismatch between the number of extremely low-income renter households and the number of units available to them with acceptable quality and affordable rents. This is a problem in absolute terms, with 6.4 million ELI households living in housing that is not affordable. And it is a problem in terms of severity, in that ELI households make up only 25 percent of renters but 76 percent of renter households with severe housing affordability problems. The median ELI household reported paying 54 percent of its income for housing in 1999.

Despite persistent and growing need, it has been more than 20 years since there was an active federal housing production program designed to serve extremely low-income households, other than a relatively small effort to replace housing demolished or otherwise lost from the subsidized inventory. The primary barrier to producing new housing for these families is that the production and operating costs of units for extremely low-income households require rents that exceed the level that they can pay.

To meet the 30-percent-of-income standard, subsidies have to be high enough to cover both capital and operating costs. Thus, even though the need is generally acknowledged, the costs are formidable and require multiyear federal expenditures. Although existing programs (especially Section 8 vouchers, Section 202, and Section 811) provide useful vehicles for addressing ELI housing needs, their funding levels are sufficient to do little more than maintain the status quo. As a consequence, several sources of subsidy are often required to serve such households.

The Commission recommends that Congress address the housing needs of extremely low-income households, as presented in the section on America's housing challenges, through a 100 percent capital subsidy for construction, rehabilitation, or acquisition of units earmarked for extremely low-income households. This new tool would be a substantial state-allocated capital source that would eliminate the need for debt on units, which would be located primarily in mixed-income developments or neighborhoods. Rents on the units would cover operating expenses, including an adequate reserve. The Commission recommends that states work with localities to specify in a state allocation plan how this new capital subsidy tool would be used to address areas of greatest need for additional ELI production in conjunction with other production resources.

The goal of this program is to increase significantly the number of good-quality rental units for ELI households, particularly the number of units located in low-poverty neighborhoods and accessible to employment. Under this proposal, rent levels would cover operating costs—including vacancy losses and adequate replacement reserves—with a reasonable margin for sustainability.

The MHC recognizes that, without additional assistance from other programs or sources, rents would exceed the 30-percent-of-income standard of affordability. Nevertheless, rents would still be lower than what ELI households typically pay—and for far better housing. As proposed, the program would only serve ELI households willing and able to pay more than 30 percent of their incomes for rent, as the overwhelming majority now does. Vouchers or other assistance would, however, be necessary to enable the very lowest-income households to pay even rents that cover only operating costs.

With a capital resource dedicated specifically to production of extremely low-income units, states could choose to apply the funds directly to mixed-income developments or in conjunction with financing through other resources, including the rent-restricted units financed with tax-exempt bonds or the Low Income Housing Tax Credit. States could also allocate the capital subsidy to local jurisdictions, including housing authorities, to supplement HOME funds and other resources. To enable states to apply the subsidy to meet a variety of situations and ELI needs, eligible uses should include new construction, preservation, and acquisition with or without rehabilitation.

Specifics of the proposed program include:

- **Administration.** The state credit agency, usually the state HFA (or a local agency if the state decides to delegate this authority), would allocate the subsidy—probably in combination with other available subsidies, although this would not be a requirement. It would also provide oversight, assuring that the proposed development meets an identified need for ELI housing and that it observes targeting and fair housing requirements.

- **Mechanism.** The program would provide additional capital funding for the units to be designated for ELI occupancy so that they would have no debt service costs, with rents reduced accordingly.

- **Income mixing.** The program would generally target 20 percent of units in new developments for ELI occupancy, although the state credit agency would have flexibility to determine the appropriate share on a property-by-property basis. State credit agencies could also allocate funds for preservation and acquisition with or without rehabilitation in mixed-income neighborhoods or as part of a revitalization plan.

- **Rent level and affordability.** Minimum rents would be consistent with sustainability, assuming zero debt service. The developer would propose sustainable ELI rents, which the state credit agency would approve. The originally approved rents would be adjusted annually based on an inflation index.[5] Since sustainable rents for the units would normally exceed the 30-percent-of-income standard for extremely low-income households, owners/developers and state credit agencies might pursue additional subsidies (such as thrifty production vouchers,[6] real estate tax abatements, HOME grants, or foundation grants) to reduce rents to more affordable levels. In addition, the units can and should be actively marketed to housing choice voucher holders.

- **Occupancy.** Only extremely low-income households could occupy the housing unless available units outnumbered applicants. In that case, the remaining units would be available to households at or below a designated income level up to 40 percent of AMI.

- **Neighborhood standards.** Low-poverty neighborhoods might be defined as all census tracts except Qualified Census Tracts, or as those with a poverty rate below, say, 20 percent. The standards for inner-city areas could differ from those for suburban or rural areas. State credit agencies could have limited flexibility to approve extremely low-income units in developments outside low-poverty census tracts, particularly in gentrifying neighborhoods or those with active revitalization programs under way.

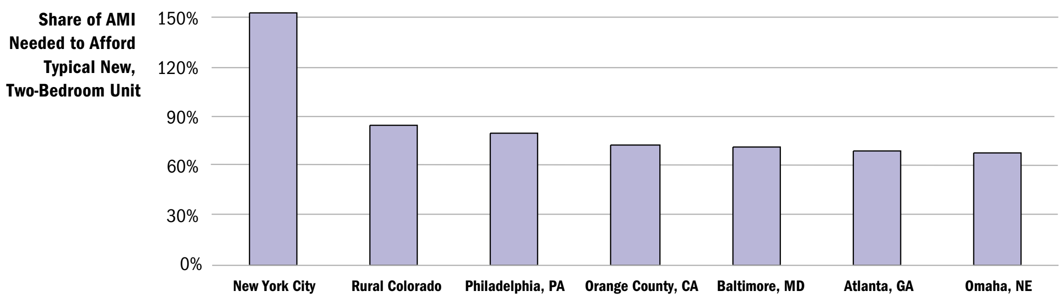
Attract private capital to the production of mixed-income, multifamily rental housing.

The MHC recommends that the limits be taken off states' ability to issue tax-exempt debt for specific multifamily properties, with the condition that eligible properties must restrict rents on at least 20 percent of the units to levels affordable to families with incomes below 80 percent of AMI. The Commission believes that access to credit, at the lowest feasible interest rate, is critical to the production of more housing. In addition, the 20-percent requirement will achieve a degree of affordability without impairing the developer's willingness to participate and will ensure that the program helps to offset the decline in rentals affordable to low- and moderate-income working families (Fig. 12).

The Commission also recommends that states have the flexibility to place rent restrictions on more than 20 percent of the units and to apply deeper targeting to the rent-restricted units, or both. This program is viewed by the Commission as both a production and a community development tool.

Figure 12

Lower-Income Renters in Many Areas Cannot Afford Newly Constructed Apartments



Source: Charlie Wilkins, *Financial Modeling Summary*, prepared for the Millennial Housing Commission, 2001.

In addition, the following federal targeting requirements should apply to use of the tax-exempt resource:

- Owners may not discriminate against applicants holding housing choice vouchers, subject to state-specified limits on the percentage of voucher holders per property in order to ensure that low-income households are not concentrated in any one development.[7]

- At least half of the low-income units should be available to ELI households through capital grants, project-based vouchers allocated by a public housing agency, or housing choice vouchers. At the option of the state agency or the relevant PHA, project-based thrifty production vouchers or other available operating subsidies might be combined with the capital subsidy to reduce rents, perhaps to 30 percent of income. State agencies should be permitted to issue this type of debt even if none of the subsidies intended to assist ELI households is available.

This tax-exempt bond authority should be in addition to the existing volume cap, which, with its companion tax credits and deeper income targeting, would remain unchanged.

The Commission recommends that Congress require states to develop parameters and criteria for the allocation of this resource, similar to the Qualified Allocation Plan (QAP) required under the Low Income Housing Tax Credit program. This suggestion relates to the Commission's vision of the tax-exempt resource not only as a tool to stimulate the production of rental housing affordable to low- and moderate-income working families, but also as a tool for community development.

Specifically, Congress may wish to require states to identify areas where multifamily housing is needed to serve a broader community development effort and where the financing tool is necessary to achieve that purpose. The Commission recognizes that states may need funding for market studies or other analyses essential to identifying places where new multifamily housing would support broader community development goals. States may wish to delegate authority to localities in some instances.

States would also identify developers eligible for tax-exempt bond financing. Beyond private for-profit and nonprofit developers, eligible applicants might include governmental entities within a state's jurisdiction (e.g., cities, counties, preservation entities, public housing authorities, regional entities, tribally designated housing entities) or private developers working in partnership with a governmental entity.

Facilitate strategic community development.

Strategic community development requires coordination of housing development with economic development, school improvement, employment and training, childcare, social services, transportation, and other initiatives to maximize the benefits of each. It also requires a combination of federal support, state leadership, and local innovation. Private-sector investments that work with public sector investments are key to assuring the reinforcement and alignment of neighborhood revitalization objectives.

Unfortunately, the many silos of categorical programs create almost insurmountable barriers to execution of comprehensive local programs. Federal funding flows to different jurisdictions, on different timetables, with unique planning, performance standards, eligibility determinations, and procurement requirements. Often these requirements are not only incompatible, but they also discourage comprehensive strategies altogether because of the time and energy required.

Funding childcare, employment and training, and enhanced transportation in connection with a housing development may involve four of five agencies with completely separate administrative structures derived from the federal authorizing statutes. The delays and barriers in assembling the desired set of resources drive up costs and discourage private-sector investment in the projects. Private investors gain confidence from well-executed, on-time performance. Such a standard is almost impossible to achieve when navigating the labyrinth of program requirements one at a time.

When state and local leadership overcome these unnecessary barriers, however, the results speak to the value of facilitating such approaches. Comprehensive community initiatives around the country—including Bethel New Life in Chicago, Community Building in Partnership in Baltimore, and the Dudley Street Neighborhood Initiative in Boston—confirm the enhanced return when public investments reinforce each other and attract private-sector investment.

The Commission believes that state and local leadership should have the tools to respond in a highly coordinated fashion to locally unique, comprehensive development proposals. The goal is prompt, consolidated review that crosses program boundaries, and streamlined administration so that private and public energies are not drained by conflicting, overlapping, and duplicate demands for information.

The Commission recommends creation of a new, more potent community development tool that builds on the lessons of successful projects while unifying funding and regulations. This proposal would allow state governors to reserve up to 15 percent of their federal block grant funds (including TANF, CDBG, HOME, Workforce Investment Act (WIA) funds, Social Services Block Grants, Child Care Block Grants, and transportation funding) to support comprehensive redevelopment projects sponsored by local governments, including consortia of local governments in rural areas.

Localities wanting to undertake such projects would apply to the state for funding through programs already administered at the state level. A consolidated program review and decision/award process for all identified programs would follow. The locality could also earmark 15 percent of the funds it receives directly from the federal government for these initiatives. Indeed, one of the factors a governor should consider in approving a request is whether the locality is willing to use its own funds to support the undertaking.

The application for consolidated funding would include a comprehensive plan approved by the appropriate local officials. The plan should include census data on the neighborhood, annual milestones and quantifiable results, description of the public participation process that produced the plan, and evidence supporting the need for a comprehensive approach. This plan would suffice for the federal planning requirements for funding streams such as HOME, CDBG, and WIA. The locality would prepare annual reports for the governor describing project progress and also supply an independent third-party evaluation. All documents would be available to the public.

Governors would have limited waiver authority to facilitate the blended use of funds within the general purposes and intent of each program. For example, in lieu of compliance with four or five income-targeting requirements, an application might suggest a uniform eligibility standard. A broader definition of eligible uses for one program might be proposed to fill funding gaps in the comprehensive plan. Basic federal standards such as civil rights could not be waived, but reporting requirements might be consolidated into a single report. Unless the responsible federal agency objected within 30 days of receiving the request, the waiver would go into effect.

The Commission notes that the Bush Administration's proposal for reauthorization of welfare contains a proposal for "superwaivers" that differs from this recommendation in several respects. First, the MHC's proposal is intended to apply only to block grant funds where states and local governments already have substantial flexibility, and the total amount subject to the waivers is limited to 15 percent of each block grant. Second, use of the funds would have to be consistent with purposes of the respective block grant programs. And third, waivers would be limited to comprehensive, geographically defined, neighborhood-based projects sponsored by local governments, so that state governments would act only in collaboration with a local initiative.

Major Reforms to Existing Programs

Several housing programs are in need of major reform. In particular, public housing and the Federal Housing Administration require significant reconfiguration to align these programs with their stated missions. In addition, the elimination of homelessness is within the nation's reach; the Commission's recommendations are meant to make this goal a reality. Finally, the MHC draws lessons from some of the successes to date of welfare reform, recommending the elimination of rules that can create disincentives to work.

Transform and revitalize the public housing program.

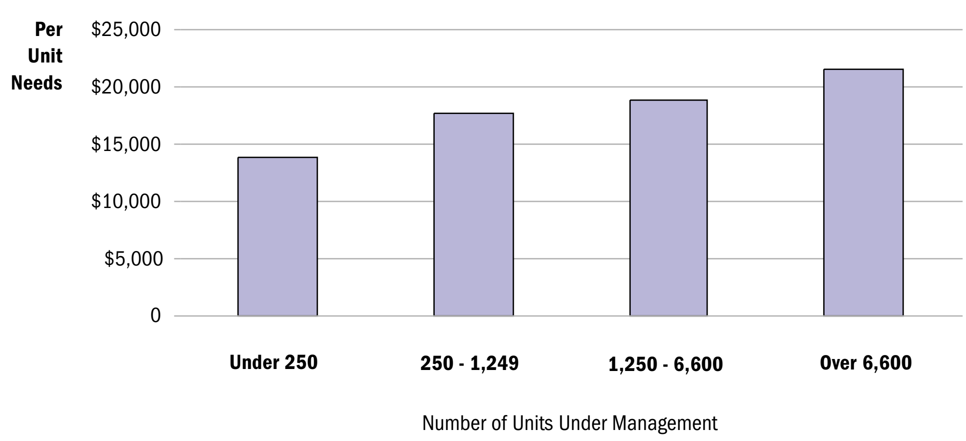
Public housing currently serves 1.3 million of the nation's lowest-income families and elderly and disabled persons. Over time, however, the program has become highly regulated and rule-bound—often serving as a laboratory for a wide, and sometimes contradictory, variety of social and philosophical ideas emanating from well-intentioned laws that have created more problems than they have solved.

The public housing authorities (PHAs) that administer the program find it increasingly difficult to meet their basic mandate while complying with the maze of regulations. The complexity and cost of compliance not only undermine the effectiveness of the best agencies, but also provide a convenient excuse for the operational failures of the least competent ones. Very small (usually rural) PHAs are particularly burdened, because they must abide by the same statutory and regulatory requirements as large, complex urban agencies but without the means—or the need—to do so.

The public housing program can better serve its customers and communities. Today, some public housing developments isolate residents[8]—typically the poorest and most vulnerable families—depriving them of real housing choices and economic, educational, and other social opportunities. In addition, many units are of substandard quality. Meanwhile, program costs continue to grow even without considering the more than $20 billion backlog of capital needs (Fig. 13).[9]

Figure 13

Large Public Housing Authorities Face the Greatest Modernization Costs



Source: Meryl Finkel et al., *Capital Needs of the Public Housing Stock in 1998: Formula Capital Study*, prepared for the U.S. Department of Housing and Urban Development, January 30, 2000.

The need for significant reform of the public housing program is clear. For large urban housing authorities, the HOPE VI program has made significant progress in revitalizing distressed public housing and surrounding neighborhoods. While the Millennial Housing Commission affirms the importance of retaining and revitalizing the existing public housing portfolio, it recommends an entirely different approach—one that more closely resembles private real estate market practices—to achieve that objective.

The MHC's recommendations should not be confused with proposals to convert the stock of public housing to tenant-based assistance. The Commission affirms the importance of maintaining a permanent inventory of housing for people with extremely low incomes that is well managed and sustainable over time. Making more effective use of the resources already available to the program and improving the existing stock of public housing for current residents are key goals of this recommendation.

1. Apply private real estate principles.

Over time, public housing's physical inventory and population would shift to the project-based Section 8 model. This entails converting operating and capital funding to a long-term Section 8-type contract[10] linked to each public housing property[11] rather than to a PHA, as is currently done. The contract would provide reliable funding to cover operating costs including asset and property management costs, debt service on loans for capital costs, replacement reserves, and debt service insurance. Subsidy levels would be based on each property's market rent. To be eligible for such a contract, the PHA would pledge to retain some specified income targets for the property.

The conversion could be voluntary at first, with a period of 7 to 10 years for completion. In this case, HUD would have to provide some oversight for PHAs that choose not to convert some or all of their stock during the transition period. If the requirement is mandatory, PHAs unable to make the change would need an alternative ownership model.

Conversion of public housing would follow a "mark to market" process similar to that which the project-based Section 8 inventory has gone through in recent years. To capture the market value of the properties and to implement an orderly transition, it is imperative that a market study and market-based physical and financial assessment be conducted for each property in a PHA's portfolio to determine the feasibility of the conversion approach. The steps to ensure a thoughtful and orderly transition are:

- ***Assess the capital, operating, and asset and property management needs of each property***[12] in the public housing inventory to determine the best debt and reserve structure. The first properties to convert would be those in the best condition and locations.

- ***Set up each property as an individually owned entity,*** with its assets outside the public housing Annual Contributions Contract (ACC) between the PHA and HUD. While the entity could be a subsidiary nonprofit corporation of the public housing authority, its assets would have to be freestanding to facilitate debt financing of capital improvements.

- ***Establish clear and widely accepted standards for redesign,*** unit and site amenities, and physical condition so that the properties are attractive to the full range of eligible families. Such standards would serve to reduce the concentration of the very poorest families in public housing.

- ***Upon turnover, permit PHAs to admit a percentage of market-rate tenants***[13] to properties where income-mixing is feasible. Use of tenant-based subsidies in areas with inadequate supply, or project-based subsidies for units in other locations (to replace the former deeply subsidized public housing units), will also help to retain affordable housing for extremely low-income families.[14]

- ***Replace the Annual Contributions Contract with a Housing Assistance Payment (HAP) contract*** as each property moves to the project-based assistance model. This immediately reduces the regulatory burden of the PHA and HUD oversight requirements. Properties that cannot or choose not to seek project-based assistance would move to a housing choice voucher-type HAP contract. HUD's public housing oversight structure would ultimately be eliminated.

- ***Use a Section 8 administrator to avoid conflict of interest*** if the PHA is the owner/manager, sets rent levels, and performs housing quality inspections. Such arrangements already exist in many jurisdictions.

- ***Involve the residents in future planning about the project.*** Neither public housing nor other rental housing is truly viable if residents and managers are unaware of or unwilling to consider each others' desires, opinions, and goals. Successful conversion of the public housing stock requires the involvement and support of residents in the planning process as well as in carrying out the transition. Throughout this process, input and participation from public housing residents and other important stakeholders should be actively sought and considered. Residents should have access to the training and technical assistance necessary to make their involvement informed and productive.

2. Provide for an orderly transition at severely distressed properties.

A more comprehensive approach is recommended for severely distressed properties in order to preserve the housing and neighborhood, as well as to restore dignity to current residents. A severely distressed property generally has multiple physical and social problems. The physical problems include age (some properties are more than 50 years old), inadequate or failing infrastructure, extremely small and inadequate rooms, and other design deficiencies. Compounding the physical deterioration of these severely distressed properties is the social pathology characteristic of high-poverty neighborhoods that is often manifested by poor school performance, low education levels, high crime rates, high unemployment rates, and longer average tenancy.[15] Given the blighting effect of these large, severely distressed properties, most of the neighborhoods in which they are located have suffered from decades of disinvestment.

The HOPE VI program must be maintained as both a preservation and production tool. In addressing severely distressed properties, HOPE VI must be the first money in, because the private sector does not have the resources to address the predevelopment costs to acquire a buildable site. Under current regulations, HOPE VI funding pays only for public housing-related costs (including the relocation, demolition, site remediation, and construction costs for public housing-assisted apartments) and leverages non-public housing funds to pay for the non-public housing costs. The latter costs make up the larger share of development budgets.

As previously discussed, each property in a PHA's portfolio would undergo a complete market-based assessment to determine the feasibility of the proposed conversion. If such an assessment reveals that the property is severely distressed but has a viable location and warrants private investment, then a HOPE VI revitalization, mixed-income approach would be considered feasible. As the property is revitalized and the multifamily component is completed, the property would be moved to a project-based voucher contract. If a property is not well located, not viable, and should be demolished, a local market assessment must be done to determine what housing resources are available to the families who must be relocated.

3. Allow debt financing of capital needs.

To complete the transition to this new public housing model, capital improvements[16] would be financed through private tax-exempt loans secured by a mortgage and backed by FHA mortgage insurance. No additional guarantees should be necessary for the majority of public housing properties, whose market rents would fully support the debt service to bring the property to acceptable quality standards. Likely lenders would include FHA multifamily lenders and, in some states, housing finance agencies.

Properties that potentially have sustainable rents[17] but do not initially meet quality standards would have a limited time to rehabilitate or replace inadequate units. During the planning and rehabilitation period, rents could be pegged to what the units would command after renovation. Additional credit enhancements or other HUD guarantees would be necessary in that, by definition, the property's condition will require financing that exceeds its market value.

If a PHA decides not to replace or rehabilitate a property, rents would be based on market value, and replacement reserves would continue to accrue. While some public housing properties need no new capital investment, others are in such poor condition or are so poorly located that they do not warrant additional investment. These properties are good candidates for demolition and replacement with vouchers or hard units, depending on input from community stakeholders, including public housing residents, as well as analysis of local markets and housing conditions.

A debt financing strategy has several merits. The long-term costs of this capital improvement approach would likely be lower than the current approach. An added benefit is that improvements can occur quickly, before properties deteriorate further. Finally, debt financing provides another level of operational oversight from lenders, thus substituting standard real estate practice for HUD oversight and regulations.

Debt financing is not, however, appropriate in all cases. For small properties, the ratio of transaction costs to overall debt makes this type of financing impractical. A more suitable approach for these properties would be to use existing capital grant programs or to front-load direct grants.

For properties whose capital needs require rents substantially above market-based levels or Section 8 fair market rents, the alternatives include:

- Using the HOPE VI program to revitalize properties that are well located but in poor condition or otherwise obsolete, and

- Granting PHAs full access to all housing development vehicles including debt financing and tax credits, as well as new loan and grant programs.

While these alternative approaches may add to the already tight competition for tax credits, the ability to compete successfully depends on the credibility of the PHA and its partners as asset and construction managers. Over time, such competition would help integrate public housing into the rest of the affordable housing delivery system and subject PHAs to the same degree of private-sector discipline as owners of tax credit properties. This suggests that Congress should consider an increase in the allocation of the Low Income Housing Tax Credit so that this resource can be used to revitalize the public housing stock without diminishing its availability for other uses.

Finally, the Commission suggests that Congress direct HUD through FHA to work with the private sector and bond-rating agencies to structure a guarantee based on the proposed Section 8 project-based appropriations. Such a guarantee would enable PHAs to leverage private-sector investment for constructing or rehabilitating units affordable to voucher holders and located in mixed-income developments.

4. Simplify the rating of PHAs.

HUD has used various systems to assess PHA competence that often focus on process compliance rather than on outcomes. At the same time, the evaluation systems have become pointlessly complex in an effort to prevent PHAs from "gaming the system." HUD needs to simplify the system to identify objectively those with determinable competence or incompetence. Such a system must:

- ***Relate to the quality of housing that residents experience*** and be simple enough to enable PHAs or other administrators to judge how they are doing. The limited successes of HUD's public housing assessment systems (such as the Public Housing Management Assessment Program and the Public Housing Assessment System) provide enough insight to design an approach that accurately gauges the quality of both housing and its management, while allowing significant input from residents and industry professionals.

- ***Prevent PHAs that do not meet minimum standards from converting to the proposed project-based program.*** If such a PHA owns some properties that do meet standards, those properties could be converted under some form of ownership that provides opportunities for resident participation and does not give the PHA complete control.

- ***Require agencies with competency problems to accept alternative management.*** Many troubled PHAs have been fixed by other PHAs acting as administrators. If no qualified administrators can be contracted, however, alternative management would be either provided by the state or procured competitively from the public, nonprofit, or for-profit sectors. Agencies with multiple problems that cannot be resolved through alternative management would have to report to an administrative or judicial receiver.

5. Test new rent-setting approaches.

Setting public housing rents has always been a balancing act among simplicity, accuracy, and equity. Today, emphasis has shifted too far toward hair-splitting issues of equity, with a predictable increase in the difficulty of achieving accuracy. This highly complex system is onerous for administrators, residents, and applicants alike.

The MHC recommends that Congress consider funding a research demonstration of alternative rent models. Rigorous research is necessary to ensure that public housing residents who are elderly or disabled (44 percent of the PHA tenant population[18]) are not forced to pay too high rents in the name of simplicity.

In addition, the rent structure should incorporate incentives for residents to seek economic opportunities. One approach would be to establish an income threshold below which residents are subject to full verification and pay a simplified income-based rent. Families with incomes above the threshold would pay a higher fixed rent based on their unit size and subject to annual adjustment. Such an approach creates real economic incentives for families in the upper-income tier, while still not burdening those with the lowest incomes.

Another approach would set rents at 30 percent of income for the first year and then “step up” the level every year thereafter. This again creates an incentive to seek economic opportunity, but gives families a full year to access services and achieve some stability.

6. Exempt small PHAs from unnecessary and burdensome reporting requirements.

Small PHAs must abide by most of the same statutory and regulatory requirements developed for large PHAs. The MHC recommends that PHAs with fewer than 250 units have a simplified contract that establishes basic standards for physical conditions and operations, but strictly limits paperwork and reporting. In this way, small PHAs can appropriately focus their staff and financial resources on property management. Even under these simplified requirements, however, some PHAs that are geographically isolated or face high staff turnover will need ongoing, reliable technical assistance.

Revitalize and restructure the Federal Housing Administration within HUD.

Revitalizing and restructuring the Federal Housing Administration is an urgent priority. FHA multifamily insurance is an indispensable tool for stimulating housing production, and FHA single-family insurance is vital for expanding homeownership among low-income families and minorities. In FY 2001, FHA endorsed more than $100 billion in mortgage insurance under its single-family and multifamily programs, and injected about $4 billion into the federal budget.[19] Indeed, unlike most federal programs and agencies, FHA is a moneymaker.

The potential of FHA to support the production and preservation of affordable housing is hampered, however, by its structure and the prescriptive statutes under which it operates. For example, although federal regulators of financial institutions are permitted to pay salaries above normal federal pay scales in recognition of the special skills demanded by sophisticated financial market operations, FHA's hiring authority is limited by statute and congressional appropriations. FHA's dependence on the appropriations process (instead of its own "earnings"), together with competition for funds within HUD, has led to under-investment in productivity-enhancing technologies that not only makes it difficult for FHA to work efficiently with its industry partners, but also increases operational risk (i.e., risk of managerial shortcomings).

The statutes and regulations dramatically increase the time necessary to develop and implement new products, keeping FHA from being fully responsive to the evolving marketplace. The nature of the political process often leads to highly specific—and sometimes contradictory—changes to programs, further curbing flexible implementation.

1. Restructure FHA as a wholly owned government corporation within HUD.

A corporate structure would give FHA maximum flexibility to adapt its programs to the evolving finance market without relying on Congress to legislate each change. This could be accomplished with no substantial budget impact.

Specifically, the Commission recommends that FHA and Ginnie Mae be combined into a single entity, based on the model laid out in the Government Corporation Control Act (GCCA).[20] The following structure would enhance FHA's unique ability to support production and preservation of affordable housing.

- ***Powers and mission.*** The new corporation would continue to issue insurance backed by the full faith and credit of the federal government, including credit enhancement and related functions such as asset management and disposition. Legislation should specify broad parameters for the insurance authorities, including creation of three separate insurance funds for single-family housing, multifamily housing, and health care facilities. Each should have its own statutory mortgage limits that focus FHA's mission on affordability. Within these parameters, however, FHA should have freedom to create or alter specific insurance programs without direction from Congress. FHA's mission must also be focused through its accountability to Congress and the Secretary's role (see below) in coordinating the corporation's activities with the rest of HUD.

- ***Governance.*** The corporation should be run by a Chief Executive Officer appointed by the President and reporting to the Secretary of HUD. The CEO's term could run for the duration of the current administration, or for a specific number of years that overlap administrations (like the terms of most banking regulators). The recommended structure is a board chaired and appointed by the Secretary of HUD; an alternative structure could be an advisory board appointed by the Secretary.

- ***Oversight.*** Like other government corporations, the new FHA corporation should be subject to regular financial and other reporting requirements, including an annual audit. In addition, an annual actuarial review should be conducted to set credit subsidy rates for the three funds, for use in the President's annual budget. Regulation of FHA's safety and soundness, particularly the adequacy of its reserves, could be the responsibility of either the Office of Federal Housing Enterprise Oversight or the Office of Management Budget.

- ***Hiring and procurement.*** FHA should have greater flexibility to pay employees according to the same standards as the federal banking regulatory agencies, including exempting workers from certain competitive and other requirements. The corporation itself should be exempt from the Federal Property and Administrative Services Act, so that it can quickly procure needed goods, contractors, and other services.

- ***Funding.*** A restructured FHA would not require additional funding because it should continue to take in more than it spends. Each year, as part of the annual budget process, the corporation should report the expected level of "earnings" to be retained for funding FHA operations and reserves. Earnings estimates would be based primarily on the actuarial review of the corporation's programs. The balance could either remain within FHA or be available for other government purposes.

With this new structure, FHA could invest in technology to improve its efficiency and reduce its risk, thereby creating production and ownership opportunities that would otherwise not exist. A corporate structure would also serve to attract staff with the requisite skills and experience to manage FHA's nearly $500 billion mortgage insurance program. Equally important, however, FHA would remain an integral part of HUD and as such, an effective force for the production and preservation of affordable housing.

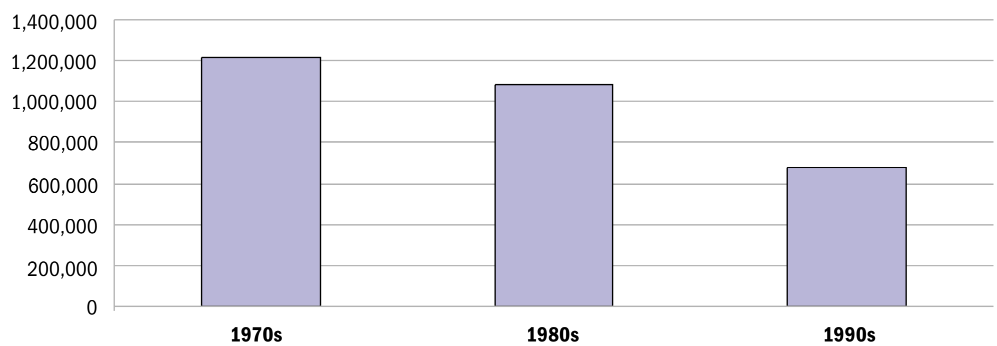
2. Provide for more flexible multifamily operations.

Statutory reforms are needed to grant FHA a sufficient degree of flexibility to improve its multifamily operations (Fig. 14). Although the Commission recommends the following changes be made as part of a restructured FHA, they would by themselves improve FHA's support of multifamily housing. At minimum, Congress should pass statutes that:

- ***Combine all multifamily programs in the General Insurance and Special Risk Insurance (GI/SRI) Fund into a single program*** for purposes of determining credit subsidy allocations. As currently structured, any individual insurance program that does not break even requires an appropriation of credit subsidy from Congress, even if other programs within the fund generate excess earnings. When the subsidy runs out, these programs must shut down for the remainder of the fiscal year unless Congress makes an emergency appropriation. A single appropriation of credit subsidy for all programs in the GI/SRI fund would eliminate this problem. Enabling FHA to manage its multifamily programs as a single fund would allow it to set premiums and target loan volumes for each program in such a way that the fund as a whole requires no appropriation of budget authority.

Figure 14

The Number of FHA-Insured Multifamily Units Continued to Fall in the 1990s



Source: U.S. Department of Housing and Urban Development, Office of Multi-Family Housing, April 2001.

- ***Permit FHA to vary the terms or other aspects of its multifamily insurance programs.*** Today, program specifics are spelled out in statutes that require congressional legislation to change. Broader authorities should replace many of these details. In crafting such legislation, Congress can look to its own FHA multifamily risk-sharing legislation, which gives FHA the flexibility to react to market changes and other conditions much more rapidly.

- ***Grant FHA broad authority to pursue pool insurance and offer adjustable-rate insurance products.*** This authority would allow FHA to respond much more quickly and effectively to market changes, for example by offering short-term or adjustable-rate mortgages when interest rates favor short-term financing.

- ***Index multifamily mortgage limits to a construction cost index*** and give FHA greater flexibility to increase limits in high-cost areas. Even with the recent 25 percent increase, current FHA mortgage limits are too low to produce new housing in high-cost areas. At present, FHA can use the maximum limit adjustment in only two states. FHA should be allowed to apply this adjustment to other areas it designates as high cost.

- ***Allow FHA to insure construction-only loans,*** including a tailored interim-loan product to cover the costs of acquiring and renovating properties. Such a program would help preservation entities purchase and rehabilitate at-risk affordable housing. The program could offer either risk-sharing or full insurance and should start as a demonstration focused initially on federally assisted properties.

- ***Build on the success of the 221(d)(4) rental production program*** (FHA's multifamily mortgage insurance program for for-profit developers) by removing outdated features limiting its effectiveness.[21]

Congress should also urge FHA to:

- Use its existing multifamily risk-sharing authority to offer pool insurance to housing finance agencies and government-sponsored enterprises, especially for financing the preservation of small properties.

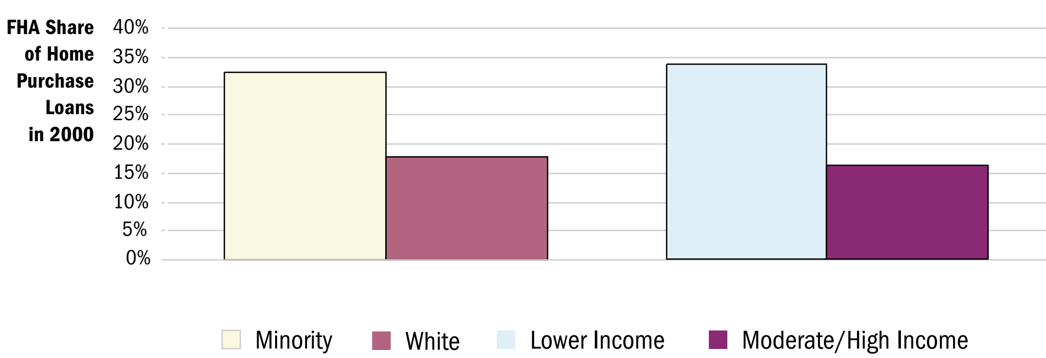
- Consider risk-sharing partnerships with private lenders, but only after carefully establishing strict criteria for participation such as capital and reserve requirements and lending track record.

3. Provide for more flexible single-family operations.

FHA lacks risk-sharing authority for its single-family programs, freedom to introduce new products and insure pools of single-family loans, and authority to set high-cost area limits without specific acts of Congress. Again, the Commission strongly believes that the best way to strengthen FHA's single-family programs is to restructure the agency as a whole. At minimum, though, the following reforms would make FHA a more responsive, flexible, and capable partner for lenders and other private-sector players.

Figure 15

FHA Is Critical to Minority and Low-Income Homebuyers



Source: Home Mortgage Disclosure Act, Community Reinvestment Act data, 2000.

- ***Expressly authorize FHA to initiate single-family risk-sharing demonstration programs*** under terms and with partners it sees fit. Present statutes grant FHA some authority to share risk with partners on single-family loans, but on very narrow terms. FHA should have broader authority to choose its partners, loss position, and types of credit enhancements (including reinsurance as well as insurance or reinsurance on pooled loans).[22]

While FHA can absorb risk better, potential partners may have superior risk assessment and management systems. Others may be able to provide access to new products and delivery systems targeting communities with underserved borrowers that FHA does not yet reach, such as the subprime mortgage market.[23] Congress should establish one FHA risk-sharing program for credit subsidy purposes and allow it to operate both programs that break even and programs that do not within this authority, provided it achieves an overall target.

- ***Authorize FHA to set its own standard for selecting business partners.*** At present, FHA approves lenders, but not appraisers, under congressionally mandated standards. FHA's inability to select appraisers and other business partners on its own terms severely handicaps its capacity to manage risk and, by extension, the risk to communities from liquidating inventories of defaulted loans.

- ***Expressly authorize FHA to introduce new products,*** such as pool insurance products, without requiring Congress to pass a new statute for each. This would offer the same benefits on the single-family side as those described for the multifamily side.

- ***Urge FHA to use sophisticated private-sector techniques to prevent mortgage defaults and, when defaults are unavoidable, reduce their cost.*** While FHA has made progress in loss mitigation and property disposition in recent years, potential partners have demonstrated far greater success in these areas. In 1998, Congress gave FHA authority to take assignment of loans for purposes of transferring them to partners who would manage loss mitigation, foreclosure, and property disposition. The authority also allows FHA to take an equity interest in a joint venture partnership, so that FHA can share in the returns generated from more efficient and effective operations. The Commission recommends that FHA implement this existing authority for defaulted loan sales to joint ventures.

  This recommendation is not to suggest that FHA should simply sell its entire inventory of foreclosed homes for the highest price. That approach has had—and would continue to have—devastating impacts on low-income people and communities. The merits of bulk sales and accelerated claim procedures for dealing with dispersed FHA-owned homes in stable neighborhoods often do not apply in low-income communities with high concentrations of vacant, dilapidated properties. In fact, Congress created special initiatives within FHA such as the "Asset Control Area" program in part to help communities combat the problems caused by bulk sales of FHA-owned homes to investors with little or no regard for the homes' habitability, the well-being of homebuyers, or the stability of the neighborhood. These initiatives should continue.

- ***Expand FHA's home improvement lending activities*** by reforming its Title I program to attract more lenders and better manage risks. Financial and other risks associated with the quality of construction and its impact on property values, combined with the relatively high fixed transaction costs of small loans and of monitoring construction progress, have reduced the number of lenders willing to administer home improvement loans. Scarce capital for these typically high loan-to-value loans also limits the availability of these products.

  FHA should take decisive steps to stimulate home improvement lending by raising Title I loan limits from $25,000 to $50,000, and reducing the administrative hurdles to loan origination. Title I insurance should also be full-faith-and-credit instead of conditional, which now allows FHA to force lenders to buy back a loan even after a claim is paid. A stronger FHA role in the market would help establish effective third-party oversight and underwriting rules others could emulate. It could also prompt Ginnie Mae to re-enter this market.[24]

- ***Expand FHA's small investor lending activities*** by reforming its Section 203(k) program for acquiring and rehabilitating two- to four-unit properties. The program's design and management contain many restrictions and carry low loan limits, making the program generally difficult to use. Few lenders will process or originate these loans, in part because they have higher administrative costs than non-FHA loans. By revising and streamlining these programs, FHA could provide a competitive product that would limit any opportunities for predatory lending by others.

End chronic homelessness in 10 years by building additional units of supportive housing.

While the accuracy of homeless counts is controversial, the best current estimate is that at least 800,000 people are homeless on any given night, and that between 2.3 million and 3.5 million people experience homelessness over the course of a given year.[25]

About three-quarters of the homeless are single adults living alone, and about 15 percent are households with children. Indeed, nearly 200,000 children are homeless on a given day.[26] In addition to those living on the streets or in shelters, an unknown number are doubled up temporarily with friends or relatives. A study of nine metropolitan areas found that between 2 percent and 10 percent of all poor families are homeless each year.[27]

The homeless can be divided into two broad groups. Up to one-third are the “chronically homeless” who experience frequent or long-term episodes of homelessness. This population—primarily single adults, although including a small percentage of families as well—generally suffer health or substance abuse problems in addition to extreme poverty.

Many of these individuals live in the homeless system, cycling from shelters to the streets to jails and hospitals—often at enormous cost. A recent study of New York City’s homeless system found that the public cost to care for a homeless, mentally ill person was roughly equivalent to the cost of housing that same person.[28] The chronically homeless require “permanent supportive housing” to escape homelessness and reduce the enormous burden on public care systems.

The “transitionally homeless,” in contrast, are households whose predominant need is rapid access to affordable housing. Overall, the transitionally homeless have more in common with the “housed poor” than with the chronically homeless. In fact, many of the needs of the transitionally homeless can be met by increasing the affordable housing supply for extremely low-income families, as well as by policies promoting employment and self-sufficiency.

The MHC strongly endorses a program to end chronic homelessness within 10 years through provision of additional supportive housing. Best estimates put the number of chronically homeless people near 200,000 and the number of appropriate units near 50,000. This shortfall calls for another 150,000 units of suitable housing over the next 10 years, along with continued funding for the 50,000 or so existing units.

The tools to achieve this goal are already in place. For the last three fiscal years, 30 percent of HUD McKinney-Vento Homeless Assistance funding has been set aside for permanent housing through the Shelter Plus Care, Supportive Housing, and Single Room Occupancy programs. The Commission recommends that this set-aside be made permanent as a way to ensure the addition of 15,000 incremental units of permanent supportive housing each year.

A related recommendation is to transfer renewal funding for expiring rent and operating subsidies for permanent supportive housing (initially funded under McKinney-Vento) to HUD’s Housing Certificate Fund. This would treat HUD-supported housing for the homeless similarly to other HUD-subsidized housing, freeing current year McKinney-Vento appropriations for investment in incremental permanent supportive housing units and other initiatives for the homeless.

Together, these two initiatives would serve to end chronic homelessness within 10 years. Policies recommended elsewhere in this report would also greatly reduce transitional homelessness. Moving these populations out of shelters and jails and off the streets is in the best interests not only of housing policymakers but of all Americans.

The Millennial Housing Commission recognizes, however, that providing extra domicile space alone cannot address the fundamental needs of either the transitionally or chronically homeless. Overall, a successful policy to solve homelessness must:

- Provide sufficient public and private funding for a full continuum of interventions targeted to various homeless sub-populations, ranging from street outreach and emergency shelters to permanent affordable and supportive housing; and

- Infuse this continuum of interventions with the high expectations, incentives, and supports needed to encourage homeless households to participate in treatment programs (to address their physical and mental health, substance abuse, and other personal conditions), work productively within the legal labor force, and otherwise engage in constructive behavior.

In this regard, future policymaking on homelessness should draw on the lessons of welfare reform. The nation's experience with the TANF program, enacted by the Personal Responsibility and Work Opportunities Act of 1996, has demonstrated conclusively that a system of narrow, unconditional public assistance is less effective in promoting self-sufficiency than one that artfully wields both sanctions and a broad array of supports. Moreover, the successful welfare reform experiment has, from its inception and throughout its implementation, recognized that a one-sized approach does not fit all target populations. Accordingly, the Commission recommends a broad spectrum of interventions in keeping with the paradigm shift that has occurred in the field of welfare policy.

Over time, link housing assistance with work requirements.

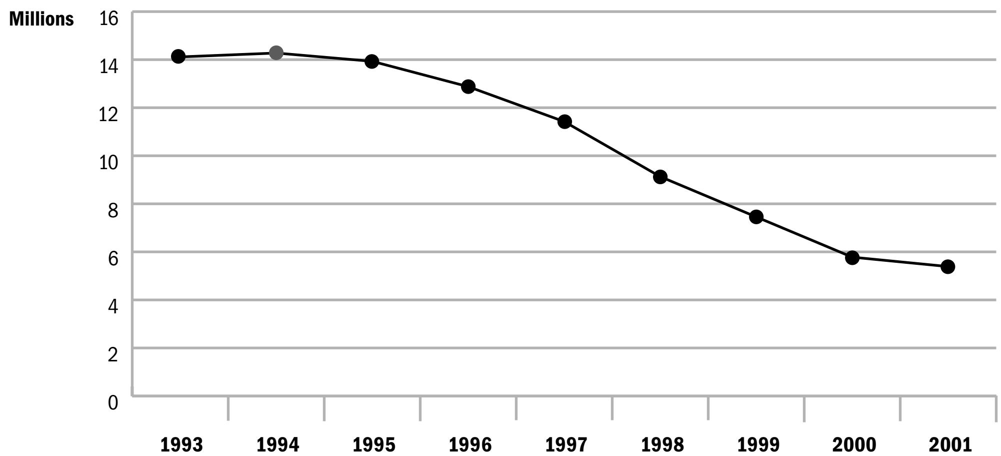
The Commission believes that more should be done to link housing assistance with economic opportunity, self-sufficiency, and personal responsibility.

The MHC recommends that federal housing assistance programs encourage and facilitate expanded economic opportunity, recognizing that working-age families living in assisted housing, like other able-bodied people, have an obligation to contribute to society as well as accept its help. Thus, MHC supports provision of the necessary services and supports to enable these families to find employment that will enable them to become self-sufficient and, when such services are available, directly or through non-housing agencies, to accompany them with realistic work requirements. The Millennial Housing Commission thus recommends that, over time, the housing assistance system require residents who are not elderly or disabled to work as a condition of receiving aid.

This recommendation is modeled on the reform of the Aid to Families with Dependent Children program, which brought about work requirements coupled with access to support services (such as childcare, education and training programs, and transportation) (Fig. 16a). This approach helps recipients get and keep jobs, plus provides financial incentives (including more generous income disregards that allow them to keep more of their earnings, and specialized savings accounts exempt from resource limitations) that make work pay.

Figure 16a

Welfare Caseloads Have Dropped Sharply Since Welfare Reform



Source: Department of Health and Human Services, Administration for Children and Families, April 2002.

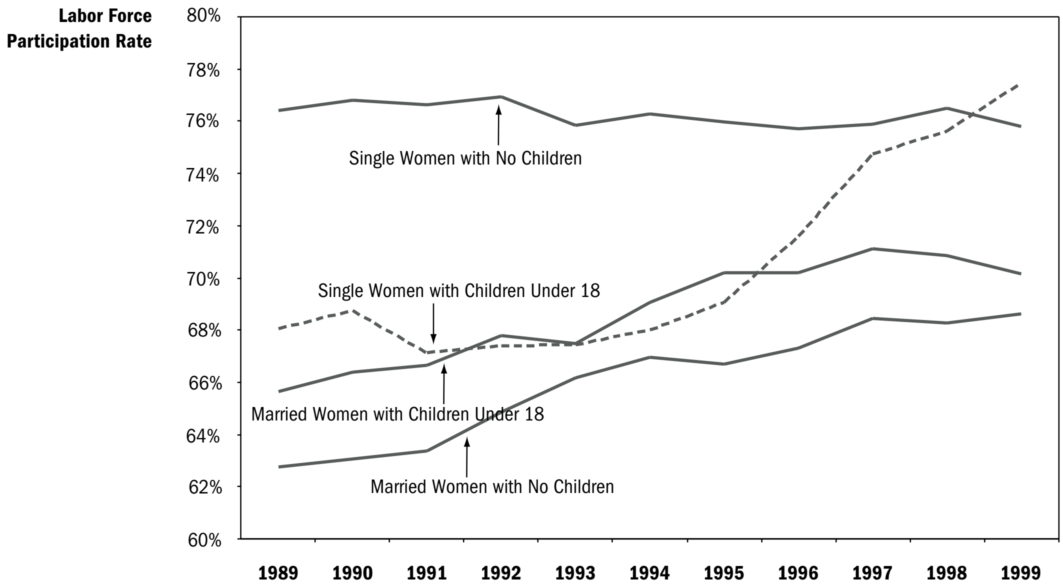
Since enactment of welfare reform and creation of Temporary Assistance for Needy Families, many states have made substantial changes to the provision of family assistance. The TANF law encouraged states to link assistance with work requirements. The combination of federal welfare reform, state flexibility in implementation, and economic expansion has led to a dramatic decrease in the number of AFDC/TANF-assisted households and a simultaneous increase in the percentage of TANF-assisted single mothers participating in the work force (Fig. 16b).

There is evidence that combining incentives to work with job-promoting services for welfare recipients is more effective for those who also receive housing assistance than for other welfare families.[29] This may be because subsidized housing provides the stability that people need to find and hold jobs, allows families to devote more of their earnings to work-related expenses such as childcare, and/or helps families move to areas with better job opportunities.

Welfare reform was the culmination of 15 years of experimentation with efforts to promote employment and self-sufficiency. Over time, welfare agencies developed expertise in social work to help families become self-sufficient. It will therefore take time and adequate funding to develop an analogous system for residents of assisted housing who are not already covered by the welfare program requirements.

Figure 16b

Employment Among Single Mothers with Children Has Skyrocketed



Source: Rebecca M. Blank, "Declining Caseloads/Increased Work: What We Conclude About the Effects of Welfare Reform?", Federal Reserve Bank of New York, *Economic Policy Review*, September 2001.

Some housing authorities have already instituted changes that help to counter the disincentives to work for assisted families. While not directly requiring work, many PHAs now disregard increased earnings in setting rents; support work requirements under state and federal welfare policy, with exceptions for elderly and disabled households; set rents at levels only households with earnings can afford; and give preference to working families in their admissions policies.

The Millennial Housing Commission recommends that Congress support continued experimentation with, and evaluation of, such policies. Experimentation with stepped and flat rents should be encouraged. In the short term, the most important job of public housing authorities is to manage their real estate properly. Over time, however, PHAs should build on the concept of linking housing assistance to work requirements.

Nevertheless, Congress should impose these requirements only if it supplies adequate funding for services to help recipients get and keep jobs, and for income disregards that allow residents to keep more of the money they earn. Furthermore, Congress should facilitate partnerships between PHAs and welfare agencies so that PHAs need not expand their missions to provide services that are already provided by other agencies.

Streamlining of Existing Programs

Several housing programs work well but would benefit from minor modifications. The recommendations presented below affirm the basic strengths of these programs and suggest ways in which they can be improved.

Expand and strengthen the housing choice voucher program to improve the access of extremely low-income households to the private housing stock.

Since the 1970s, the housing voucher program has effectively assisted millions of low-income renters—particularly extremely low-income households who are most likely to have severe affordability problems and/or live in inadequate housing. The voucher program now serves 1.6 million households, including several special-needs populations such as persons with physical or mental illness and families making the transition from welfare to work. In certain circumstances, vouchers can also be used for mortgage payments to help families become homeowners.

Because the program is flexible, cost-effective, and successful in its mission, the MHC believes housing vouchers should continue to be the linchpin of a national policy providing very low-income renters access to the privately owned housing stock.

The MHC recommends appropriation of additional funds for substantial annual increments of vouchers to address the housing problems of extremely low- and very low-income families who lack access to other housing assistance. The MHC also supports expanded use of vouchers for homeownership to help low-income families build assets. Finally, the MHC recommends specific refinements that would increase the program's efficiency and effectiveness.

1. Improve utilization and success rates.[30]

HUD needs to diagnose the reasons for the limited success of the voucher program at some PHAs and offer targeted technical assistance.[31] Voucher units should be reallocated from low-utilization PHAs to entities serving the same geographic area and households. Where reallocation is not feasible, the PHA could be required to contract with another entity to administer the unused vouchers. In all cases, households on the original PHA's waiting list should have priority for the unused vouchers.

HUD could also make two simple administrative changes that would improve the voucher system in tight rental markets: (1) expand the resources devoted to rent surveys so that published Fair Market Rents do not lag actual rents, and (2) quickly approve exception payment standards when census data demonstrate that average area rents are at the level of the exception sought (with some appropriate upper limit).

2. Increase landlord participation.

HUD and PHAs should develop consensus standards for shortening the inspection and lease approval process and for providing better service to landlords. These standards should be based on a review of PHA performance, feedback from both landlords and voucher holders, and review of all standards that affect landlord participation, such as lease approvals, inspections, and voucher transfer payments.

The MHC also recommends that HUD provide technical assistance to PHAs for improving landlord participation, disseminate best practices information to program administrators, experiment with giving PHAs greater flexibility in applying the Housing Quality Standards (HQS) to attract owners to the program, and change the cap on the family rent contribution for newly rented voucher units to 40 percent of gross (rather than adjusted) income.[32]

3. Link vouchers to housing production programs.

The MHC recommends that HUD strengthen and enforce the requirement that owners of housing produced under federally funded programs accept households with vouchers. This is in an effort to enable extremely low-income families to live in rental housing produced with other subsidy sources that would otherwise be unaffordable.[33] In the interests of promoting mixed-income housing, however, the MHC also recommends that owners of developments of 50 or more units be able to limit the share of voucher households to 20 percent or 30 percent, subject to local market conditions.

Extremely low-income households would receive special vouchers for units produced under capital subsidy programs such as the LIHTC, HOME, CDBG, and the new mixed-income, multifamily rental production program proposed elsewhere in this report. Payment standards for units served by these "thrifty production vouchers" would equal the operating cost, rather than being based on the Fair Market Rent. These vouchers could be targeted to places where the tenant-based voucher program has had little success, or where there is a severe shortage of rental units at or below the program Fair Market Rent. In addition, state and local housing plans would be required to take into account voucher success rates and barriers to voucher use when determining the use of HOME and CDBG funds. These funds could be used for voucher program enhancements, such as assistance with searches or security deposits.

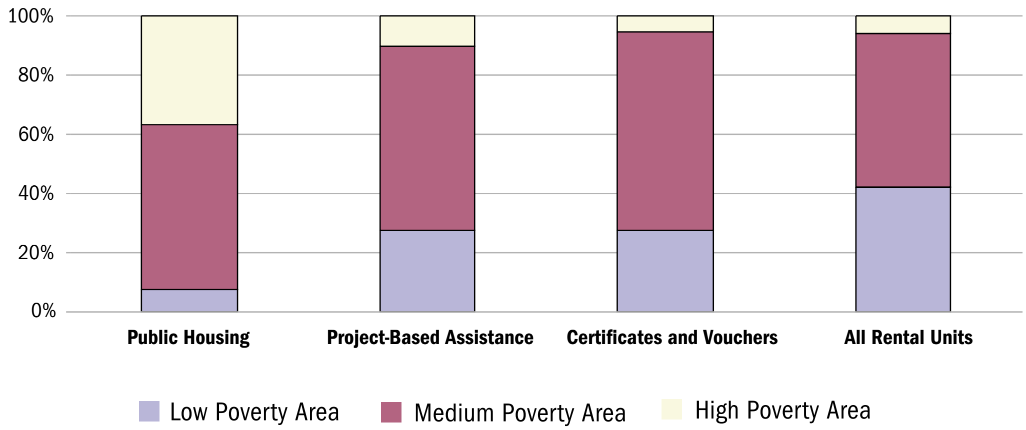
PHAs should be allowed to designate a portion of available housing vouchers for "first use" in a particular housing project. This would supplement the current system of project-based vouchers, but not guarantee the owner a specific number of voucher holders over time. These designated vouchers should be allowed only in neighborhoods with access to jobs and decent schools, or as part of a comprehensive revitalization project that addresses these other aspects of neighborhood quality.

4. Link vouchers to work opportunity and self-sufficiency initiatives.

While the current voucher program provides incentives for tenants to move to neighborhoods with better opportunities and good schools, it does not make mobility a primary goal. But housing vouchers can play a larger role in helping welfare-dependent families and marginally employed workers improve their job stability and earnings potential. Indeed, vouchers are more effective than any other kind of housing assistance in improving recipients' opportunities for employment, savings, and long-term self-sufficiency (Fig. 17).

Figure 17

Housing Choice Vouchers Help Recipients Move to Lower Poverty Areas



Note: Low poverty areas defined as tracts having under 10% of households at or below poverty level; medium poverty areas as having 10-39% of households at or below poverty level; and high poverty areas as having over 40% of households at or below poverty level.

Source: Sandra J. Newman and Ann B. Schnare, "'...And a Suitable Living Environment': The Failure of Housing Programs to Deliver on Neighborhood Quality," *Housing Policy Debate* 8:4, 1997.

The ability of the voucher program to help families become more self-sufficient may depend in part on its ability to assist families in moving to neighborhoods with access to good jobs and good schools. As the Moving to Opportunity (MTO) demonstration[34] has shown, however, effective mobility counseling is expensive. In addition, the goal of mobility competes with other program objectives such as maximizing the number of households served, minimizing the dependency of households on public subsidies, and ensuring the full utilization of program funding.

Another way for the voucher program to help families move toward self-sufficiency is to build in opportunities for employment and savings. Among the current HUD programs aimed at increasing employment and income among voucher holders, the Family Self-Sufficiency (FSS) program[35] has shown particular promise.

5. Link vouchers to non-housing programs.

HUD should allow other agencies to compete for special allocations of vouchers for certain populations, but require that PHAs (or regional consortia of PHAs) perform key operations such as housing inspections, rent-setting, and payments to landlords. HUD should monitor performance of these functions as part of the PHA's overall voucher program.

Housing vouchers can also work effectively with other types of assistance programs for special-needs populations. In particular, as states expand community-based housing options, they are likely to look increasingly to vouchers to provide permanent housing supports for persons with disabilities. This will require establishing stronger partnerships between PHAs and other providers of supportive services, and permitting state agencies and nonprofits to administer special-purpose vouchers.

6. Allow for the flexible use of Section 8 project-based units.

In addition to expanding tenant-based housing choice vouchers, the Commission proposes certain improvements to the project-based Section 8 program. More than 800,000 units of project-based Section 8 units are still in the federally assisted stock. While most are in good condition, some are obsolete, deteriorating, and located in areas where assisted housing is highly concentrated. Others are at risk of opt out from their Section 8 contracts.

Unfortunately, the treatment of project-based Section 8 units is rather inflexible. Current HUD policy does not appear to allow the transfer of subsidies from deteriorated properties to other locations to create replacement housing. Although the Mark-to-Market program can help rehabilitate properties that are in relatively good condition, it makes better economic sense to demolish and replace some obsolete or poorly located properties.

It would be a better use of federal funds if, with local government support, some or all of the project-based Section 8 and other subsidies could be transferred to other locations as part of mixed-income housing developments. All companion use and affordability restrictions would also be transferred to the new properties. The ability to transfer subsidies would thus help preserve existing affordable housing now at risk of loss.

This flexibility would also provide new preservation options for property owners who are considering opting out of their contracts. Owners would have the opportunity to do a partial opt-out, converting some but not all units to market rate. This partial conversion would foster income-mixing in the housing development by attracting residents with higher incomes. Other properties assisted by shallow subsidy programs (such as LIHTC and HOME) could use the transferred subsidies to serve some very low-income renters.

HUD currently has authority to transfer project-based Section 8 contracts to other developments. There do, however, appear to be statutory issues involved in transferring existing contracts to new construction projects intended to replace obsolete units, and in transferring companion use restrictions to other buildings under Mark-to-Market transactions. The Commission therefore recommends that the administrators of these project-based contracts be permitted and encouraged to allow transfer of assisted units to aid in the preservation of affordable units in high-quality properties and to improve income diversity. It also recommends that Congress remove any statutory obstacles to using transferred project-based Section 8 subsidies for replacement housing. These recommendations are in keeping with the Commission's emphasis on devolving greater responsibility to state and local entities and providing greater program flexibility to increase the public benefit.

Improve the HOME Investment Partnerships and Low Income Housing Tax Credit programs to work better individually and in combination, and increase funding for HOME.

As the MHC heard time and again in testimony, housing programs must be flexible enough in implementation to enable local actors to tailor federal resources to local needs. Two modern housing production programs—the Low Income Housing Tax Credit and the HOME Investment Partnerships Program—are, to a large degree, highly successful precisely because they were designed with flexibility in mind.

The LIHTC was enacted in the Tax Reform Act of 1986. The program provides housing developers with a source of equity—generated by private-sector investors—that enables them to achieve affordable rents on new or rehabilitated rental units. Without such equity, rents would have to be significantly higher to cover the cost of amortizing debt.

The LIHTC is administered by state credit agencies (usually state housing finance agencies). Federal program guidelines are spelled out in the Internal Revenue Code (IRC). Through the IRC, the federal government defines tenant income and rent restrictions, generally describes the Qualified Allocation Plan (QAP) process that credit agencies must use in awarding credits to projects that propose to serve such tenants, outlines the eligible project costs for which the credit may be used, explains how investor benefits relate to eligible project costs, and lays out compliance requirements for investors.

Credits are allocated annually to state credit agencies on a per capita basis. The agencies then award credits to individual developers via the state-developed QAP, which identifies statewide housing needs and lays out the agency's ranking factors given those needs. Allocators have enormous flexibility in designing their QAPs. In effect, through its QAP requirement, the federal government mandates that state credit agencies define the public benefit to be achieved through the use of the tax credit, which is essentially a public subsidy.

Developers who compete successfully for a credit allocation then sell their credits to private-sector investors, with proceeds of the sale providing project equity. Investors derive economic return as long as the property remains in compliance for the required period of time. The statute requires a 15-year initial compliance period and mandates an extended-use agreement under which properties must continue to serve low-income tenants for an additional 15 years, but with a contingency clause that allows for conversion to market rate under certain conditions.[36]

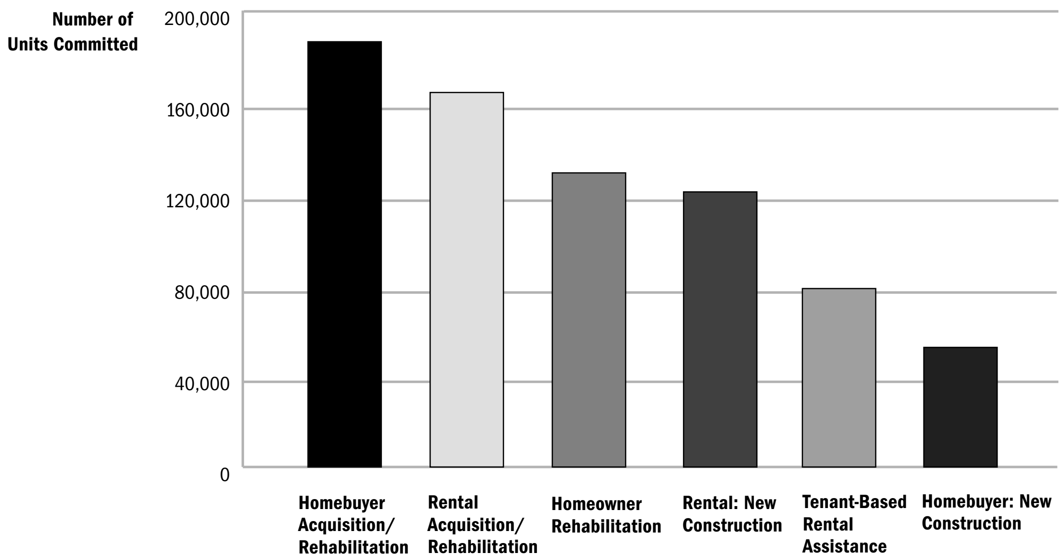
Enacted in the National Affordable Housing Act of 1990, HOME is a federal block grant program administered by the U.S. Department of Housing and Urban Development. Grants are allocated annually, by formula, to states, localities, and consortia of local governments. The federal government determines the allocation formula, sets overall program objectives and eligibility requirements for applicants and beneficiaries, and defines eligible and ineligible uses of the funds. Beyond that, HOME fund beneficiaries have great flexibility to determine how best to use the funds to meet local needs.

In addition to expanding the supply of affordable—particularly rental—housing for low- and very low-income families, one of the stated national objectives of the HOME program is to "strengthen the ability of state and local governments to design and implement strategies for achieving adequate supplies of decent, affordable housing."[37] Funds can also be used for capacity-building assistance to beneficiaries, and to strengthen partnerships between beneficiaries and the private sector.

Both LIHTC and HOME have helped to build the capacity of state and local jurisdictions to engage in housing development (Fig. 18). The LIHTC in particular has imposed private-sector discipline on state credit agencies and developers who benefit from tax credit equity, because private-sector investors in LIHTC-funded projects face severe tax penalties should the projects fail to comply with IRC requirements. State credit agencies are required to monitor projects' physical condition and compliance with federal tenant and rent restrictions, so private-sector investors demand effective public oversight of the projects, otherwise they risk losing the economic benefit of having invested. Indeed, a uniquely clever element of the LIHTC program is that private-sector investors are compelled—by the potential for economic loss—to assure that the public objectives of the program are met.

Figure 18

HOME Provides Flexible Funding for a Variety of State and Local Housing Initiatives



Source: U.S. Department of Housing and Urban Development, Community Planning and Development, HOME program data as of February 28, 2002.

The LIHTC and HOME programs represent a true and strong paradigm shift away from some of the less effective federal policies and programs of the past. States and cities—not the federal government—now determine how to use most housing resources. The LIHTC, in particular, builds on lessons learned about providing incentives for private-sector involvement in housing. LIHTC's program design eliminates many of the perverse incentives that resulted in costly long-term problems with the privately owned, subsidized stock. Congress has recognized the success of both programs by recently increasing the per capita tax credit allocation from $1.25 to $1.75 and pegging the credit to inflation beginning in 2003. In fiscal year 2002, Congress funded the HOME program at its highest level ever.

The Commission's recommended improvements to the LIHTC and HOME programs are meant to eliminate outdated requirements and thereby provide even greater flexibility for states and localities to respond to local production and preservation needs. After proposing several improvements to each program, the MHC provides a third set of recommendations that would make the LIHTC and HOME programs work better both together and with other programs.

1. Improve the Low Income Housing Tax Credit Program.

- ***Allow sponsors of tax credit properties in low-income rural areas to set rent caps based on statewide median income.*** This recommendation is intended to facilitate use of the tax credit in rural areas where the median income is too low relative to construction costs to stimulate multifamily housing production. The proposed change would allow states to extend eligibility, where appropriate, to developments whose rents are affordable based on statewide (rather than countywide) median incomes. Additional subsidies will be necessary to make an appropriate portion of the units available to extremely low-income families.

- ***Remove impediments to the use of tax credits for preservation.*** Repealing IRC §42(d)(2)(B)(ii) would make it easier to transfer desirable tax credit properties to preservation entities. This "antichurning" provision precludes a property from receiving an allocation of acquisition tax credits if it has changed hands within 10 years. The 10-year rule was put into place to prevent owners from selling or transferring properties in order to gain tax benefits. Because Congress has since eliminated or restricted these tax benefits, the 10-year rule is now obsolete.

- ***Remove the prohibition against combining LIHTC with assistance under the §8(e)(2) moderate rehabilitation program.*** IRC §42(c)(2)(B) precludes a moderate rehabilitation property from receiving an allocation of tax credits. This prohibition was imposed because of concerns about inappropriate awards of assistance in the early 1980s. The overriding concern today, however, is the need to preserve affordable housing for long-term affordable housing use. Repeal of this provision would support this goal.

- ***Clarify what project costs can be included in eligible basis.*** Ambiguity about what costs may and may not be included in eligible basis is a fundamental problem in the development and financing of tax credit properties. Five Technical Advice Memoranda issued by the Internal Revenue Service (IRS) in late 2000 in response to confusion over the eligibility of particular costs resulted in IRS positions contrary to common industry practice. The Commission recommends that Congress provide needed clarity on this issue.

2. Improve the HOME Investment Partnerships Program.

- ***Given the widely recognized success of the HOME program, enact a substantial increase in HOME funding for both states and local jurisdictions.*** In addition, the Commission recommends raising HOME's minimum state funding level from $3 million to $5 million, with the increase in the minimum funding level coming from the overall state portion of the substantial increase recommended above. This minimum funding level increase would affect allocations to 12 states.

- ***Allow the use of HOME funds to capitalize a long-term project reserve account.*** Under current regulations, HOME funds may be used to capitalize an initial operating deficit reserve to meet any shortfall during project rent-up. Long-term reserves, in contrast, are the only cost for which a developer must secure private debt, which complicates the process of financing HOME projects. The Commission recommends that Participating Jurisdictions (PJs) be given the option to use HOME funds for long-term project reserves.

- ***Permit Participating Jurisdictions to use HOME funds to refinance certain low-income housing mortgages,*** regardless of whether refinancing is done in conjunction with rehabilitation. Certain subsidized rental properties in jeopardy of loss—including tax credit and rural multifamily projects—could be preserved if the PJs were able to use HOME for refinancing. The Commission recommends that PJs be permitted to do so.

- ***When rental housing is financed with both HOME and CDBG funds, HOME rules should govern.*** When HOME and CDBG funds are used for the same housing initiative, the sponsor must comply with conflicting rules. The Commission suggests remedying this by letting HOME rules govern the use of both resources.

- ***Improve lead hazard evaluation and control by incorporating lead safety into general housing rehabilitation activities.*** First, the Commission recommends repeal of the language in Title 10 (1992 legislation on lead-based paint regulations) that triggers full abatement of lead-based paint when $25,000 in HOME and/or CDBG funds are used for rehabilitation. Evolving knowledge about lead hazards suggests that a specific abatement trigger unnecessarily increases rehabilitation costs and discourages cities from using block grant funds for preservation. HUD requirements for lead-safe work practices by contractors with basic training in lead safety, followed by clearance testing, offer a better, performance-based standard for most federally funded rehabilitation projects.

  Second, the Commission recommends that requirements for lead hazard evaluation and control apply to properties built before 1960, rather than before 1978. Properties built before 1960 are not only more likely to contain lead-based paint, but also to contain paint with higher concentrations of lead that covers more surfaces. In most cases, following lead-safe work practices and relying on real estate disclosure and clearance testing are sufficient in post-1960 properties.

3. Eliminate barriers to combining the LIHTC with HOME and other programs.

- ***Make both new construction and substantial rehabilitation expenditures eligible for the 9 percent tax credit,*** even when the development is federally assisted. Under current law, developments that use loans funded out of appropriations are, with some exceptions, eligible only for 4 percent credits. This provision was enacted in 1986 and intended to prevent over-subsidization of projects. Beginning in 1990, however, housing credit allocation agencies were required to perform a financial feasibility analysis to determine the amount of credit needed per project in light of other sources. This requirement, along with the allocating agencies' desire to make the credit available as widely as possible, ensures that projects receive no more credit than necessary. The Commission recommends that allocating agencies be permitted to match 9 percent credits with such projects as necessary to provide deeper subsidies than possible using only 4 percent credits.

- ***Allow a "basis boost" for tax credit developments in high-poverty, high-cost areas, even when they also receive HOME assistance.*** This recommendation would eliminate a barrier to using the credit for new development or substantial rehabilitation in high-poverty areas where development costs are high relative to AMI. To encourage use of the tax credit in such areas, current law provides for a "basis boost" of up to 30 percent for tax credit properties. The statute, however, makes developments using HOME funding ineligible, effectively discouraging use of the tax credit. It should therefore be eliminated.

- ***Delegate subsidy-layering reviews for tax credit properties to state allocating agencies.*** Section 102(d) of the Department of Housing and Urban Development Reform Act of 1989 requires the Secretary to certify that HUD assistance to any housing project is no more than necessary to make the project feasible, taking into account other forms of assistance. Section 911 of the Housing and Community Development Act of 1992 specifies that this requirement for projects receiving HUD assistance and tax credits can be satisfied by certification from the housing credit agency to the HUD Secretary, within certain guidelines. IRC §42(m)(2) also requires allocating agencies to assure that the amount of credit allocated to a project is no more than is needed. The Commission therefore recommends repeal of §102(d) and §911, as well as delegation of the subsidy-layering review to state allocating agencies. Congress may wish to direct these agencies to certify to the HUD Secretary that subsidy use meets agreed-upon guidelines.

- ***Allow states to use Temporary Assistance to Needy Families (TANF) funds for one-time grants to existing tax credit properties*** without reducing the properties' eligible basis, as long as owners agree to reduce rents for eligible families for an agreed-upon period. IRC §42(d)(5)(A) reduces the eligible basis of a LIHTC building by the amount of any federal funding, thus effectively preventing states from using TANF funds to reduce the debt service and operating costs of such properties. The Commission believes that allowing states the option to make one-time grants from TANF funds in return for deeper targeting and longer periods of affordability would provide important support for former welfare recipients.

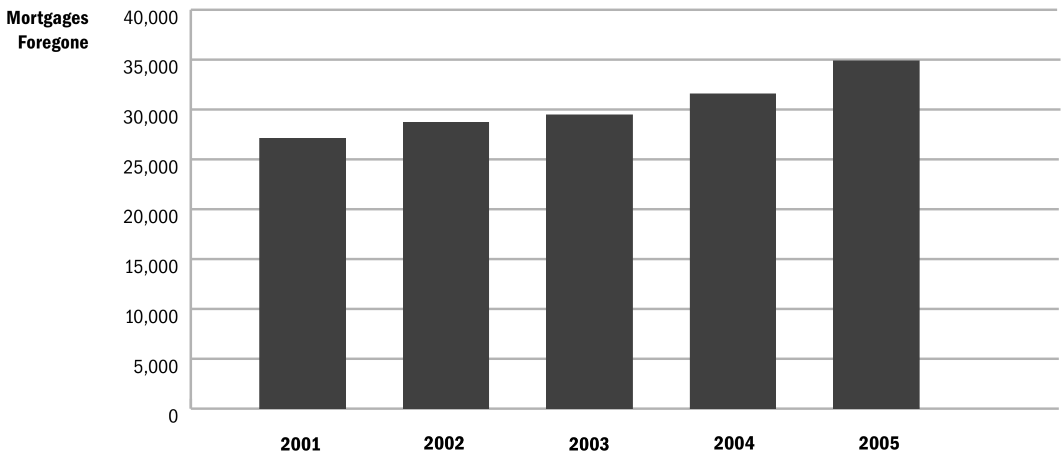
Expand states' ability to use the Mortgage Revenue Bond program.

Subject to various restrictions, state housing finance agencies typically use the proceeds from Mortgage Revenue Bond (MRB) issues to generate additional mortgages. Initially, HFAs could use all the payments from MRB-financed mortgages to issue new mortgages. In 1988, however, HFAs were required to use principal payments received after 10 years from bond issuance to pay off the bonds. This now-obsolete requirement was enacted when the MRB program faced an imminent sunset.

The mortgage volume lost due to the 10-year rule has been significant. Losses over the last four years have totaled nearly 109,000 mortgages. Through 2005, the 10-year rule is expected to result in additional lost mortgage volume of about $2 billion to $3 billion—or upwards of 27,000 mortgages—annually (Fig. 19).[38]

Figure 19

Repeal of the Ten-Year Rule Would Increase Low- and Moderate-Income Homeownership Substantially



Source: National Council of State Housing Agencies, 2001 Projections of 10-Year Rule Impact.

MRBs also have limited ability to finance home improvement loans, with the $15,000 maximum unchanged since the MRB law was first passed. This restriction prevents MRBs from being used for high loan-to-value home improvement and acquisition/rehabilitation loans.

The Commission recommends repeal of the Mortgage Revenue Bond program's 10-year rule, which would increase the resources available to states for homeownership. This measure would allow states to issue more mortgages without additional appropriations, enabling more families to buy homes through below-market-rate loans. Repeal would also reduce pressure on the private activity bond cap by drawing "recycled" mortgage funds into the pot of housing finance resources available to assist low-income households.

A second, complementary recommendation relates to a restriction on "prepayment refundings" that repeal of the 10-year rule would exacerbate. HFAs currently have 18 months to issue mortgages funded from MRB proceeds. If mortgages are prepaid within 10 years of issuance, HFAs can either issue "refunding bonds" to redeem bonds whose mortgages have been prepaid or use the funds to issue new mortgages. HFAs have only six months, however, to issue new mortgages using prepayment funds.

HFAs seek to provide mortgage funds efficiently by timing their bond issues with movements in interest rates and seasonal changes in demand, while minimizing issuing costs from having too many small issues too frequently. It is inefficient for an agency to borrow money that will be spent within six months. The 18-month exception for original issuance recognizes this reality. The Commission recommends that the same exception be applied to mortgages financed out of prepayment funds.

The Commission also makes the following recommendations to address issues related to other restrictions on MRBs.

1. Given enforcement of income limits, remove the limits on the purchase prices of homes financed. Purchase price limits were enacted when the program had no income limits. Currently, underwriting standards combined with income limits in effect amount to appropriate purchase price limits.

2. Given enforcement of income limits, repeal the first-time homebuyer eligibility requirement so that low-income owners who need to sell and relocate to take advantage of employment or other opportunities can still benefit from the program. The Commission recommends that Congress consider permitting states to adopt rules beyond the current recapture provision to ensure that repeal of the first-time homebuyer eligibility requirement does not result in windfalls to sellers of properties financed under the program that have appreciated significantly.

3. For states that issue Veterans Mortgage Bonds, remove restrictions limiting eligibility to Veterans who were "on active duty before January 1, 1977, and applied for financing within 30 years of being on active duty."

4. Increase the limits on MRB home improvement loans to the FHA Title I loan level.

Revise federal budget laws that deter affordable housing production and preservation.

Budget laws inhibit HUD—as well as other government departments and agencies—from entering into contracts requiring more than one year's funding. In the case of Housing Assistance Payment (HAP) contracts, this restriction has led to the introduction of language in multiyear contacts that subjects HUD's payment obligation under the agreement "to the availability of sufficient appropriations."

This language, known as the "HAP condition," essentially transfers the appropriations risk to owners and lenders. This added uncertainty about payment encourages owners either to remove their properties from the affordable stock or to defer needed maintenance and repair. Lenders predictably protect themselves against this risk by avoiding such properties, requiring reserves, and/or making smaller loans at higher rates with more stringent terms.

The HAP condition thus discourages private-sector investment in affordable housing, but without in any way reducing federal expenditures or obligations. Appropriations for housing assistance under Section 8 have never been—and are unlikely ever to be—decreased. Even if the HAP condition were exercised, the government would still be obliged to provide resources to manage the transition from project- to tenant-based subsidies. Thus, while the HAP condition is largely meaningless, neither owners nor lenders view it as such.

The Commission recommends that Congress make a serious effort to address the issues raised by the HAP condition in order to preserve the existing stock of government-assisted affordable housing. The Commission believes that the best policy would move project-based Section 8 HAP contract funding from the discretionary part of the budget (where program funds are subject to annual appropriations) to the mandatory category (where programs are run using permanent spending authorities that do not require annual congressional action). Congress could establish the authority with appropriate budgetary controls that could limit the total amount of funding available and the terms of the new contracts using this authority, for example, while at the same time adding extra assurances that the subsidies will continue to support tenant rent payments over a longer period of time. This change would serve to attract more private-sector capital to affordable housing and follow Congress's practice of funding all of these contracts every year.

This proposal is sound from a budgetary standpoint since both the Congressional Budget Office and the Office of Management and Budget include the entire cost of project-based funding in the federal budget baseline each year. The effect of this proposal on the long-term budget situation would be neutral relative to this baseline. This mandatory baseline will never grow faster than already anticipated in the budget and would be designed to preserve the same number of units under an existing contract. If an owner opts out or HUD fails to renew the contract, funding for replacement units would come out of the mandatory account.

Alternatively, Congress could take other steps to shift the Section 8 renewal appropriations risk away from property owners, lenders, and tenants and toward the federal government. For example, the federal government could at little cost offer indemnities or sell some form of insurance that would add an incentive to lenders/owners to minimize the appropriations risk in their pricing.

Supporting Recommendations

The Commission presents the following supporting recommendations.

Increase funding for housing assistance in rural areas.

By definition, rural areas are both remote and lightly populated. Many small town and farming communities were bypassed in the recent good economic times. As a result, poverty rates, unemployment rates, and the incidence of housing problems are at levels approaching those of the nation's big cities.

But rural housing needs are harder to serve than most urban needs, and are often neglected by major federal housing production programs such as HOME, CDBG, and the Low Income Housing Tax Credit. As a result, the Rural Housing Service (RHS) programs of the U.S. Department of Agriculture have been the primary source of rural housing assistance since 1949.

In addition to underfunding, rural areas face unique housing challenges. In particular, homeownership is the predominant tenure in rural areas, and there are far more owners than renters with affordability problems. Moreover, housing vouchers often do not work because there is not enough supply from which to choose.

In recent years, federal spending on rural housing programs has been dramatically reduced. As a result, few new housing units have been added in the poorer, more remote rural areas that the Department of Agriculture has historically served. There is substantial demand and need for rural housing assistance, and backlogs for loans are at historic highs. The Commission believes that federal rural housing programs are an important element of the nation's housing finance and delivery system, and that Congress and the Administration should therefore increase appropriations for low-income housing in rural America.

Specifically, the Commission recommends that Congress provide adequate funding for core RHS housing programs, including Section 515 rental housing, Section 521 rental assistance and housing assistance for farm workers, Section 502 homeownership loans and guarantees, and others. It should also ensure that rural areas receive their fair share of resources from other federal production programs based on objective measures of proportionate housing need. States need to pay special attention to the needs of rural areas as they allocate funding through these programs.

Increase funding for Native American and Native Hawaiian housing.

The housing and finance needs of native peoples are urgent. According to the latest census data, the poverty rate among the nation's 2.5 million Native Americans in 2000 was more than twice the national average.[1] Forty percent live in overcrowded or physically inadequate housing.[2] Current estimates point to the immediate unmet need for 220,000 affordable housing units, plus related infrastructure.[3] The nation's 399,000 Native Hawaiians and other Pacific Islanders have serious housing needs, as well.

While housing programs serving these populations are properly targeted to their unique needs, funding levels have been consistently inadequate. The Commission recommends that Congress increase funding for the Native American Housing Assistance and Self-Determination Act (NAHASDA) block grant, and makes the following specific recommendations:

1. Increase funding for capacity-building, technical assistance and training, and the creation of Community Development Financial Institutions (or similar lending institutions) on reservations. Support for housing development is allocated through the NAHASDA block grant rather than through predetermined programs and plans. As a result, tribes need training and technical assistance to understand how best to use this and other resources. In addition, there is a critical need for institutions on Native American reservations to manage the financing for housing construction, rehabilitation, and home improvement loans.[4]

2. Fund the Land Title Commission to examine mortgage-lending practices and provide additional funds to the Interior Department to accelerate the mortgage lending process. Land issues in Indian Country are extremely complex. Approximately three-quarters of all Indian land is held in trust by the U.S. Government on the tribes' behalf. The Commission urges Congress to provide funding for the Land Title Report Commission to analyze and improve the current system for maintaining ownership records and title documents, as well as for issuing certified title status reports.

3. Increase funding for housing-related infrastructure needs through Indian Health Services and the Rural Utility Service. Many tribal communities lack the basic infrastructure necessary for economic and community development. Seventy-three percent of all tribal water treatment facilities are considered inadequate,[5] and fewer than 50 percent of homes on reservations are connected to a public sewer.[6] More funds are needed to eliminate these health and safety hazards.

4. Increase funding for the newly enacted Native Hawaiian Housing Assistance Program. Nearly half of all Native Hawaiians experience problems of housing affordability, overcrowding, and structural inadequacy. There are approximately 20,000 families currently on a waiting list for a lease on a spot on a Hawaiian Home Land.[7] There is a serious lack of access to capital on such lands, as there is in much of Indian Country on the mainland.

5. Develop a demonstration program for the provision of housing for tribal college students and faculty. There are 32 tribal colleges today, most of which are located in isolated areas where housing is in short supply. The American Indian population has become increasingly younger, and college education that is obtainable is critical for improving the self-sufficiency of future generations. Tribal colleges receive little or no funding from state governments.

6. Broaden the ability of tribes to issue tax-exempt private activity bonds for housing. Current law effectively prohibits a borrower in a tax-exempt issuance from relying on future federal financial assistance (e.g., guaranteed payments) to repay the loan. While various exemptions from this prohibition do exist, none is for programs tailored to Indian tribes. Under current law, tribes can issue tax-exempt bonds for rental units owned by the tribe and leased to tribal members, but not for single-family or multifamily units owned by qualified residents. In addition, tribes cannot issue tax-exempt bonds for rental housing owned by a partnership in which the tribe is a member.

Establish Individual Homeownership Development Accounts to help more low-income households buy homes.

An estimated 3.6 million renters are unable to buy homes because they cannot cover the cash outlays needed for downpayment and closing costs.[8] Individual Homeownership Development Accounts (IHDAs) are an innovative way to help low-income families save money for this purpose.

In partnership with the financial industry, an IHDA program would help make homeownership possible for more families. Similar to 401(k)s, these accounts would offer matching funds from private and public sources for each dollar saved. Participants would also receive valuable financial education and counseling. To encourage households to open IHDAs, it might be useful to provide incentives to employers, financial institutions, nonprofits, foundations, and family members to match up to $2,500 in annual IHDA savings.[9] Tax deductions for these matching funds would create additional incentives to participate in the program.

In this spirit, the Commission recommends that the 401(k) and IRA statutes be amended to allow financial institutions to monitor IHDA deposits for Community Reinvestment Act credit. This will encourage institutions to participate in asset-building for account holders in a cost-efficient way since the basic administrative structure is already in place. IHDA program monitors would be responsible for tracking deposits and their use for up to five years, ensuring that families who either violate program terms or do not use their funds pay taxes on a portion of the accrued value.

Allow housing finance agencies to earn arbitrage.

Arbitrage is the "the nearly simultaneous purchase and sale of securities or foreign exchange in different markets in order to profit from price discrepancies."[10] The federal government restricts the amount of arbitrage a housing finance agency can earn on "purpose" and "nonpurpose" investments of Mortgage Revenue Bond (MRB) proceeds. In the case of MRBs, purpose investments are mortgages and nonpurpose investments are everything else. Earnings on purpose investments are limited to 1.125 percent above the interest rate paid to bondholders; earnings on nonpurpose investments that exceed the interest rate paid to bondholders must be rebated to the Treasury.

Compliance with these restrictions is costly for state HFAs, and removing or relaxing them would result in negligible federal revenue losses. The current limit on the spread between the bond rate and the mortgage rate on housing bonds was imposed 20 years ago, when conventional rates were relatively high compared with MRB rates. Since then, the spread has narrowed considerably because mortgage market innovations have in effect set an upper limit on tax-exempt bond mortgage rates. This translates into limited potential for arbitrage earnings. In addition, the rebate requirement has discouraged HFAs from making nonpurpose investments that yield arbitrage.

The Commission therefore recommends that Congress repeal or liberalize federal restrictions on housing agencies' ability to earn arbitrage on mortgage bond proceeds. This measure would increase the amount of federal assistance available to support low-income housing without additional annual appropriations. Indeed, removing the restrictions entirely would allow resources now spent on compliance to be devoted instead to housing.

To limit any potential federal revenue loss, Congress could set a maximum arbitrage rate (as it already does in the case of mortgages made from bond proceeds), or limit the period during which unlimited arbitrage can be earned on nonpurpose investments.

Exempt housing bond purchasers from the Alternative Minimum Tax.

Congress created the Alternative Minimum Tax (AMT) to ensure that all taxpayers pay a minimum amount of tax. For constitutional reasons, Congress did not impose the AMT on bonds issued to finance local government facilities, but it did impose it on the interest earnings on otherwise tax-exempt housing bonds.

This circumstance not only keeps many investors out of the housing bond market, but it also raises the cost of financing for affordable housing. For example, in early 2002, interest rates on state-issued housing bonds exempt from the AMT were 15 to 35 basis points lower than those subject to AMT.[11] For the federal government, the cost of eliminating this burden would be insignificant. Because few investors who own housing bonds are subject to the AMT, the federal government collects little income from the tax.

The Commission recommends that housing bond purchasers be exempt from the Alternative Minimum Tax.

Undertake a study of the Davis-Bacon Act requirements.

Enacted during the Depression, the Davis-Bacon Act was intended to protect the wages of construction workers. The act requires builders on all federally funded or assisted projects to pay at least the local "prevailing wage" on any construction contracts valued at more than $2,000. The prevailing wage is calculated as either the wage that a majority of workers in that craft receive or, lacking a majority, a weighted average of all the wages paid in that craft in the locality.

Evidence presented to the MHC suggests that wage levels set under this procedure are higher than actual wages paid. Clearly, this appears to be a serious issue in at least some parts of the country and for certain types of construction systems. The Commission is concerned about any requirements that raise the cost of housing. At the same time, however, it is aware that Davis-Bacon effectively increases incomes for construction workers, thus enhancing their economic opportunity.

Given the competing viewpoints, the Commission recommends that Congress undertake a study of the Davis-Bacon requirements and make improvements in such areas as the accuracy of the wage data, the applicability threshold, and the reporting requirements.

Address regulatory barriers that either add to the cost of or effectively discourage housing production.

However well intended, regulations may either increase the cost of housing production (making units less affordable) or effectively discourage production. The Commission recommends that Congress consider three approaches for addressing the effects of such regulations.

One approach to removing such barriers, already passed by the U.S. House of Representatives (H.R. 3899), is to require all federal agencies to include a housing impact analysis as part of the rule-making process. The housing impact statement would serve to focus consistent attention on the question of how proposed rules and regulations might affect home prices.

Each housing impact analysis would include: (1) a description of the reasons why action is being considered; (2) a succinct statement of the objectives of, and legal basis for, the rule or regulation; (3) a description of and, where feasible, an estimate of the effects that the rule or regulation would have on the cost or supply of housing or land; and (4) identification, to the extent possible, of all relevant federal rules that may duplicate, overlap, or conflict with the proposed rule or regulation.

H.R. 3899 also reauthorized grants, originally included in the Housing and Community Development Act of 1992, that would serve as incentives for states and localities to develop strategies for removing regulatory barriers. It also required communities to demonstrate a "good faith effort" to remove barriers when they submit their Consolidated Plans to HUD for HOME and CDBG funding. Finally, H.R. 3899 proposed establishment of a clearinghouse within HUD to collect and disseminate information on regulatory barriers and their effects on the availability of affordable housing.

A second approach would be to establish a demonstration program to provide planning grants to localities committed to combining land-use regulations into a comprehensive "balanced growth code" that has "workforce housing affordability" as a key ingredient. The grants would go to jurisdictions that already demonstrate leadership in this area, with "lessons learned" ultimately applied more broadly.

Finally, the Commission recommends that the federal government create funding incentives for localities to incorporate accessible housing standards already mandated under federal law into their local building codes.

Streamline state planning requirements for community development programs.

Federal planning requirements for the various funding streams used for housing and community development are narrow and prescriptive, and are often an exercise in paperwork. The Millennial Housing Commission recommends that Congress encourage states to develop plans that establish basic principles such as the importance of sustainability, define housing needs and target areas, list priorities (such as mixed-income development or accessibility for the disabled), outline a menu of resources, and request project proposals that offer solutions.

Planning requirements should be flexible enough to allow states to consider transportation, smart growth, and economic needs in setting priorities. Some combination of citizen participation and review, public disclosure, and public hearings is fundamental to this process. State and local fair housing enforcement agencies should also be involved from the start, with adequate funding to make this possible. All allocation decisions should derive from the plan.

The Commission further recommends that states that successfully develop a comprehensive strategic plan should be able to request a waiver of standard program planning requirements. To be eligible for such a waiver, however, the strategic plan would have to detail how the state would address the set of needs and priorities of the particular funding agency.

Expand the financing options for small multifamily properties.

While the secondary market for large multifamily properties (defined as properties with 50 or more units) is developing rapidly, the same is not true for small multifamily properties (with 5 to 49 units). Some of the factors contributing to this lag are limited understanding among property owners about financing options; lack of economies of scale in underwriting, servicing, and creating mortgage-backed securities; and the declining presence of thrift institutions—the traditional source of finance for small multifamily properties.

This financing gap not only weighs against the production of smaller, usually urban, rental properties, but it also hampers preservation of existing units. With more than one-third of all rental structures falling within the small multifamily category, providing a strong secondary market for these loans is an important way to preserve and expand the affordable supply. To address this gap, the Commission recommends the following measures:

- Create an FHA small multifamily pool insurance program. Loans for small multifamily properties can be unprofitable because of their perceived risks and the high costs of credit enhancement relative to loan size. The Commission recommends the creation of FHA pool insurance for small multifamily properties to facilitate loan pooling, diversify risk, and reduce credit enhancement costs. Such a program would give local lenders an outlet for small multifamily loans at lower cost than current FHA programs.

- Streamline FHA's existing small multifamily whole loan insurance. Although FHA introduced its Small Project Processing program in the 1990s to increase small multifamily lending, the program has attracted little interest from lenders. The Federal Home Loan Bank (FHLB) of Boston has, however, demonstrated that eliminating unnecessary and costly requirements would increase its usage. FHA should work with the Boston FHLB to make these changes, and reach out to other Federal Home Loan Banks to encourage local banks to originate FHA-insured small multifamily loans.

- Encourage the government-sponsored enterprises and lenders to make loans for small multifamily properties. HUD's affordable housing goals already encourage Fannie Mae and Freddie Mac to make small multifamily loans. The Federal Housing Finance Board may wish to consider similar goals for the Federal Home Loan Banks, while state housing finance agencies could adopt their own goals. The Commission recommends extending small multifamily financing goals to other lenders as a way to direct energies into this market. Congress could also encourage the Federal

Home Loan Banks to support multifamily lending through initiatives to make advances on favorable terms.

- Fund national data collection on multifamily lending and promote standardization of lending practices. Relative to loan size, the costs of underwriting and servicing small multifamily loans, as well as making securities out of small multifamily loan pools, are higher than those for large multifamily loans. These high fixed costs could be reduced by improving and centralizing information sources for appraisals, environmental reviews, and loan performance, and by standardizing documents, bankruptcy rules, and title requirements.

  The Commission recommends a national data collection effort to analyze the risks of multifamily lending. While reducing the costs of all multifamily loans, this would especially benefit small multifamily lending. The Multifamily Housing Institute has already made significant advances toward this goal, but progress has stalled because of insufficient funding for startup and operating costs, and because of the uncertain commitment from the government-sponsored enterprises to supply data.

Foster a secondary market for development and construction lending.

One of the last major challenges for the housing finance system is to develop a robust secondary market for development and construction loans. Without such a market, these loans will remain unnecessarily expensive—adding to rents and home prices and preventing the production of new housing in areas of high risk but great need.

Capital for housing development and construction comes primarily through equity of various types, which is expensive. It also comes through commercial banks and thrifts that hold loans in their portfolios rather than sell them into the secondary market. In fact, a recent survey shows that 97 percent of development loans, 91 percent of single-family construction loans, and 100 percent of multifamily construction loans come from commercial banks and thrifts.[12] As a result, the loans do not benefit from the lower rates and liquidity provided by the secondary market. Moreover, during credit crunches when concerns over credit quality drive lenders out of the market, production can slow considerably and drive costs up even further.

To develop a secondary market for development and construction loans, the Commission recommends that Congress:

- Encourage the Federal Home Loan Bank System to launch a pilot program establishing a "private" secondary market for construction loans. The first step in creating an efficient secondary market typically begins with development of a private program that tests the market's potential on a limited scale. The FHLBs could launch a demonstration program through which they would purchase construction loans from member banks, thereby building data and standards that could be applied by others. These loans could be held in portfolio or sold into the secondary market. Over the longer term, the pilot program could include purchase of development loans, especially for in-fill and urban redevelopment where lack of financing is a major constraint.

- Urge the Treasury Department to publish detailed guidance on the use of Financial Asset Securitization Investment Trusts (FASITs). FASITs provide a vehicle for securitizing construction, development, and other types of loans by allowing the same favorable tax and accounting treatment that single-family mortgages receive through Real Estate Mortgage Investment Conduits (REMICs). Greater access to the secondary market for development and construction loans through FASITs would expand the capital available for housing. Lack of regulatory guidance from the Treasury Department, however, has greatly limited the use of FASITs. The Commission recommends that the Treasury Department quickly provide clear and appropriate guidance so the intent of Congress in creating this mechanism can be realized.

- Permit FHA to issue construction-only insurance. The full-faith-and-credit of the federal government is the most powerful credit enhancement available. By indemnifying investors against losses from construction-only loans with pre-specified and less costly terms, FHA could attract secondary-market investors. FHA already insures construction-to-permanent loans. As noted in the

Commission's proposal to revitalize the Federal Housing Administration, FHA should offer both individual and pooled construction-only products, working both alone and in tandem with risk-sharing partners to deliver them.

- Grant government-sponsored enterprises express authority to purchase construction-only loans. It is unclear whether the GSEs can purchase construction-only loans. Their charters should therefore be amended to give them explicit authority to do so.

- Require banking regulators to collect data, as well as publish sufficiently detailed reports on the activity and performance of real estate loans. Loan activity and performance reports from banking regulators should separate out results for commercial and residential real estate loans. The reports should also provide detail on the three major types of loans—land acquisition, land development, and construction—within these broad categories.

Launch a demonstration project for comprehensive community-based work.

Some neighborhood-based needs and initiatives fall outside the boundaries of traditional federal anti-poverty programs. In addition, government cannot provide all of the funding needed for the intensive community development required.

Private foundations have funded many demonstration projects that combine affordable housing development, economic development, job training, childcare, and transportation projects to improve all systems in a neighborhood at once. The Commission recommends combining the interest and resources of these large philanthropies with funding from the federal government.

This new public-private partnership could be modeled on the National Community Development Initiative (NCDI), a funding collaborative that includes the Department of Housing and Urban Development, major foundations, banks, and insurance companies. NCDI directs funding to community development corporations (CDCs). Three dollars of private foundation money are matched by one dollar of HUD funding in a pool used to improve the community development infrastructure in 23 selected cities. HUD participates equally with the private sector in funding decisions.

Under the new partnership, the Departments of Health and Human Services, Housing and Urban Development, Transportation, and Labor could participate in a pool that would also receive contributions from major foundations. The three-to-one private-sector match would apply. The new partnership would, however, funnel money to a broader set of community-based nonprofits focused on affordable housing development, job training, health care, childcare, transportation, and other appropriate community development activities.

A board composed of representatives of the private foundations and public agencies would make funding decisions. Localities would apply to this board for funding.

Improve consumer education about home mortgage lending.

Many consumers enter the mortgage application and homebuying process without full knowledge and understanding of how to obtain the best loan for their circumstances. Accurate comparisons of loan terms, fees, and requirements can be difficult. Even with real estate disclosures and truth-in-lending laws, consumers can fall prey to deals that put their homes at risk.

Recent research by Freddie Mac indicates that face-to-face pre-purchase education and counseling reduces loan delinquencies by as much as 34 percent.[13] The evidence suggests that counseled buyers are not only less likely to end up with unfair loans, but they are also better prepared for the responsibilities of homeownership. Federal support for homebuyer education and counseling is crucial to the expansion of this practice. State and local governments, as well as the private sector, will likely follow the lead established by HUD and other federal agencies. Stronger disclosure laws and more vigorous enforcement of existing laws are also important.

In addition, increased competition in emerging mortgage markets could help to protect consumers. Currently, borrowers with blemished credit histories can acquire loans—typically subprime loans—from finance companies only. Because alternative lenders are largely absent from markets where these consumers are most concentrated, some 10 percent to 35 percent of subprime loan borrowers were unaware that they could have qualified for prime loans.[14] Without vigorous competition and pricing standards in the subprime market, qualified borrowers are less likely to seek out more favorable loans.

The Commission recommends that Congress enact regulatory changes to educate and protect consumers in mortgage transactions, as well as assure that loans are made at fair and reasonable credit costs. The MHC's specific recommendations are:

1. Refocus HUD efforts to build the capacity of a delivery system for homebuyer education.

2. Revise and expand HUD funding for homebuyer counseling, and require disclosure of the provider and cost of education on HUD-1 settlement documents.

3. Direct other federal programs to review opportunities for providing reasonable incentives to consumers and industry for incorporating counseling and education into the homebuying process.

4. Improve consumer protection regulations, such as the Real Estate Settlement Procedures Act and the Truth in Lending Act, so that disclosures are easier to understand, more reliable, and timelier.

5. Encourage HUD to push for greater standardization in subprime emerging markets.

Finally, the Commission recommends that financial institutions design debt-consolidation or second-mortgage products to improve the ability of low-income homeowners to tap their equity. Nonprofit organizations and local governments have used deeply subsidized mortgages as a way of promoting homeownership among such households, who often struggle to manage consumer debt or need cash for emergencies but are currently prohibited from refinancing. Borrower counseling should be a condition of refinancing or issuance of a second mortgage.

Improve manufactured homebuyer and owner access to capital markets.

Manufactured housing plays an important role in meeting the nation's affordable housing needs. During the 1990s, manufactured housing placements accounted for one-quarter of all new housing starts[15] and, from 1997 to 1999, 72 percent of new units affordable to low-income homebuyers.[16]

The manufactured housing industry has evolved in the last decade to deliver a better-quality product that saves as much as 25 percent of development costs.[17] Indeed, recent innovations in design, including multi-stories and attached garages, make manufactured housing a viable alternative for urban in-fill developments.

Development of an appropriate financing system for manufactured housing has not kept pace with these design and quality improvements. Until very recently, few lenders were willing to finance manufactured homes as real estate, except where land was owned or a land lease was in place that extended beyond the mortgage loan term. While this is now changing, lenders are still unwilling to finance most manufactured housing on leased land with anything but costly personal property installment loans. In addition, they are reluctant to finance purchase of an existing manufactured home, especially if it has been moved from its original location.

These constraints make credit crunches—largely a thing of the past for buyers of other types of housing—common in the manufactured housing market. They also reinforce the vulnerability of households living in manufactured homes. Some states address the vulnerability issue by offering tenants of leased-land communities first-refusal rights if the land is sold. Tenants in these states have the right to create a collective bid for the estate within a set period of time. If their bid is reasonable, they then have the option of purchasing the estate as a cooperative. In at least one state (Washington), though, the supreme court struck down the state's right-of-first-refusal law, asserting that it interferes with an owner's right to sell.

The Commission recommends that:

- Congress (a) affirm that Fannie Mae and Freddie Mac can purchase manufactured home loans classified as personal property, (b) encourage support of a secondary market in such loans if they are determined to be sound, and (c) establish performance goals for manufactured home loan purchases.

- FHA's Title I and II programs be promoted and loan limits be increased.

- Ginnie Mae approve more lenders as issuers/servicers, or instruct current issuers to make and service loans for manufactured homes.

Affirm the importance of the Community Reinvestment Act.

The Community Reinvestment Act (CRA) obliges banks and thrifts to serve the credit needs of low- and moderate-income individuals and communities. Particularly in the last 10 years, CRA has succeeded in encouraging banks and thrifts to better serve these markets. Lending to low- and moderate-income borrowers surged in the 1990s in part because of the efforts of banks and thrifts to comply with CRA. The Commission therefore:

- Affirms the importance and benefit of CRA to the goals of expanding homeownership, as well as producing and preserving affordable housing.

- Acknowledges the need for periodic reassessment of the rules governing CRA compliance, assignment of grades, and use of grades in approving, denying, or conditioning bank applications for mergers and acquisition.

- Acknowledges the need for periodic reassessment of CRA's coverage of mortgage lending activity in light of shifts in the types of financial institutions that originate and supply the capital for mortgage loans.

Affirm the importance of the government-sponsored enterprises.

By integrating the U.S. housing finance system with national and international capital markets, the government-sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—have met their primary mission of bringing liquidity to mortgage markets. This has improved mortgage pricing and helped to insulate borrowers from economic shocks. In addition, while other capital suppliers faced with distressed local markets often restrict credit or abandon these markets, the GSEs continue to supply mortgage credit, which helps to stabilize regional economies.

Due to the GSEs' special nature, they broaden access to homeownership opportunities. At no direct cost to the taxpayer, they lower the cost of mortgage credit for all low- and moderate-income borrowers. For example, Fannie Mae and Freddie Mac use automated underwriting systems that drive down transaction costs and expand the pool of accepted applicants. Through new products, the GSEs have been able to increase their purchases of loans to low- and moderate-income homebuyers, as well as to investors in rental properties that serve these families. Through strengthened outreach efforts, they have increased mortgage originations in low-income, minority neighborhoods.

As mission-driven GSEs, Fannie Mae and Freddie Mac have developed risk management methods that provide secure underpinnings for $2.7 trillion of the $6.2 trillion in residential mortgage debt that they guaranteed or held in portfolio at the end of 2001. Furthermore, working with their partners—including mortgage insurers, lenders, loan origination and servicing companies, and housing finance agencies—they help ensure that homebuyers, homeowners, and large multifamily property investors have continuous access to mortgage credit.

The Federal Home Loan Banks also play an important role in achieving these housing goals. Although they hold only 2 percent of outstanding mortgage debt,[18] the FHLBs have about $450 billion in outstanding advances to their member banks and thrifts—almost all of which are collateralized by whole mortgages.

In light of the demonstrated value of the GSEs, as well as their potential to help their partners expand homeownership opportunities among immigrants, minorities, and low-income households, the Commission:

- Affirms the ongoing importance of the GSEs to (a) manage the credit and interest-rate risk inherent in mortgage lending, (b) assure the stability and liquidity of the mortgage finance system, and (c) expand homeownership and rental housing opportunities.

- Supports the current regulatory system for Fannie Mae and Freddie Mac, and cautions against modifications that would compromise the integrity of the secondary markets.

- Recommends that Congress and HUD support full, safe, and sound GSE activity in subprime, manufactured housing, home improvement, small multifamily, and development and construction lending. One specific impediment to the full participation of the FHLBs in such new initiatives that should be removed is the restriction on creating subsidiary or affiliated corporations, either on an individual or joint basis. This limitation has hampered the flexibility and efficiency of the FHLBs, and it does not apply to the other GSEs.

Endnotes

Why Housing Matters (pages 7 to 11)

1. Rachel G. Bratt, “Housing and Family Well-Being,” *Housing Studies* 17:1 (2002): 13-26.

2. Robert Haveman, Barbara Wolf, and James Spaulding, “Childhood Events and Circumstances Influencing High School Completion” *Demography* 28:1 (1991): 133-57. U.S. General Accounting Office, *Elementary School Children: May Change Schools Frequently, Harming Their Education* (Washington, D.C.: GAO/HEHS-94-45, 1994).

3. See literature reviews in Jeffrey M. Lubell, Kathryn P. Nelson, and Barbara Sard, “How Housing Programs' Admissions Policies Can Contribute to Welfare Reform Efforts,” *Housing Policy Debate*, forthcoming, and Barbara Sard and Jeff Lubell, *The Increasing Use of TANF and State Matching Funds to Provide Housing Assistance to Families Moving From Welfare to Work* (Washington, D.C.: Center on Budget and Policy Priorities, February 2000).

4. Cynthia Miller, et al, *Reforming Welfare and Rewarding Work: Final Report on the Minnesota Family Investment Program* (New York: Manpower Demonstration Research Corporation, September 2000).

5. Thomas P. Boehm and Alan M. Schlottmann, “Does Homeownership by Parents Have an Economic Impact on Their Children?” *Journal of Housing Economics* 8 (1999): 217-232. Denise DiPasquale and Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, December 1997). Edward Scanlon, *Homeownership and Its Impacts: Implications for Housing Policy for Low-Income Families* (St. Louis: Center for Social Development, Washington University, 1996).

6. Daniel Aaronson, “A Note on the Benefits of Homeownership,” *Journal of Urban Economics* 47 (2000): 356-369.

7. Richard Green and Michelle White, “Measuring the Benefits of Homeowning: Effects on Children,” *Journal of Urban Economics* 41 (1997): 441-461.

8. Donald Haurin, Toby Parcel, and R. Jean Haurin, “The Impact of Homeownership on Child Outcomes,” *Low-Income Homeownership: Examining the Unexamined Goal* (Washington, D.C.: Brookings Press, expected 2002).

9. Gary W. Evans, Hoi-Yan Erica Chan, Nancy M. Wells, and Heidi Saltzman, “Housing Quality and Mental Health,” *Journal of Consulting and Clinical Psychology* 68:3 (2000): 526-530.

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11. Doc4Kids Project of Boston Medical Center, Children's Hospital, *Not Safe at Home: How America's Housing Crisis Threatens the Health of Its Children* (February 1998).

12. Ingrid Gould Ellen and Margery Austin Turner, “Does Neighborhood Matter? Assessing Recent Evidence,” *Housing Policy Debate* 8:4 (1997): 833-866. Sandra Newman, Joseph Harkness, and Wei-Jung J. Yeung, *Neighborhood Poverty, Assisted Housing, and the Educational Attainment of Children* (1999). Revised paper prepared for Moving to Opportunity conference, Washington D.C., November 21, 1997.

13. James J. Mazza and William M. Reynolds, “Exposure to Violence in Young Inner-City Adolescents: Relationship with Suicidal Ideation and PTSD,” *Journal of Abnormal Child Psychology* 27:3 (1999): 203-13. Margaret Wright Berton and Sally D. Stabb, “Exposure to Violence and PTSD in Urban Adolescents,” *Adolescence* 31:122 (Summer 1996):

489-98. Naomi Breslau, et al, "Traumatic Events and Post-Traumatic Stress Disorder in an Urban Population of Young Adults," *Archives of General Psychiatry* 48:3 (1991): 216-22.

14. James E. Rosenbaum, "Changing the Geography of Opportunity by Expanding Residential Choice: Lessons from the Gautreaux Program," *Housing Policy Debate* 6:1 (1995): 231-269. Jens Ludwig, Greg Duncan, and Helen Ladd, "The Effects of MTO on Baltimore Children's Educational Outcomes," *Poverty Research News, Joint Center for Poverty Research* 5:1 (2001): 13-15. Greg J. Duncan and Jens Ludwig, "Can Housing Vouchers Help Poor Children?" *Brookings Institution, Children's Roundtable 3* (July 2000). Jeffrey R. Kling, Jeffrey B. Liebman, and Lawrence F. Katz, *Bullets Don't Got No Name: Consequences of Fear in the Ghetto* (Chicago: Joint Center for Poverty Research, April 2001).

15. Early results from the Moving to Opportunity program, a strong randomized experimental design, are mixed. In Boston, early results suggest little impact on employment. See Lawrence F. Katz, Jeffrey R. Kling, and Jeffrey B. Liebman, "Moving to Opportunity in Boston: Early Results on a Randomized Mobility Experiment," *Quarterly Journal of Economics* 116:2 (2001). In Chicago, however, moving to a better neighborhood is, so far, also correlated with positive employment outcomes. Emily Rosenbaum and Laura E. Harris, "Residential Mobility and Opportunities: Early Impacts of the Moving to Opportunity Demonstration Program in Chicago," *Housing Policy Debate* 12:2 (2001): 312-346.

16. Anthony Downs, *Neighborhoods and Urban Development* (Washington, D.C.: The Brookings Institution, 1981). William G. Grigsby and Louis Rosenburg, *Urban Housing Policy* (New York: Center for Urban Policy Research, Rutgers University, 1975). James R. Cohen, "Abandoned Housing: Exploring Lessons from Baltimore," *Housing Policy Debate* 12:3 (2001): 415-448.

17. It remains unclear, however, whether it is flagging demand for the housing in such neighborhoods, independent of the influence of a few vacant properties, that causes both the initial few abandoned properties and the growing many. What is clearer is that demolition is more common in areas with greater concentrations of poverty and concentrations of housing affordable to the poor. This is the finding of a study by Tsuriel Somerville and Cynthia Holmes. Note that the model of filtering and demolition used does not contain a control for rental vacancy rates or proportion of abandoned properties in the zones analyzed. Therefore, concentration of poverty and affordable units may be proxies for other housing market conditions. See C. Tsuriel Somerville and Cynthia Holmes, "Dynamics of the Affordable Housing Stock: Microdata Analysis of Filtering," *Journal of Housing Research* 12:1 (2001): 115-140.

18. U.S. General Accounting Office, *Urban Development Action Grants: An Analysis of Selection Criteria and Program Results* (Washington, D.C., 1989). Ingrid Gould Ellen, Michael Schill, Scott Sussin, and Amy Ellen Schwartz, "Do Homeownership Programs Increase Property Values in Low-Income Neighborhoods?" *Low-Income Homeownership: Examining the Unexamined Goal* (Washington, D.C.: Brookings Press, expected 2002).

19. Anthony Downs, *New Visions for Metropolitan America* (Washington, D.C.: The Brookings Institution, 1994).

20. Frank E. Nothaft, *Trends in Homeownership and Home Equity: Report to the Consumer Federation of America's National Forum to Promote Lower-Income Household Savings* (Washington, D.C.: November 2000).

21. In 2001, the average homeowner lowered their interest rate by 115 basis points. This led to a $10 billion savings in 2001 (based on an average loan size of $132,000) and a monthly average savings of approximately $100. Freddie Mac, *Homeowners Dramatically Lowered Their Mortgage Rates in 2001 as Housing Continued to Shore Up Economy* (Washington, D.C.: Press Release, February 20, 2002).

22. Leland C. Brendsel, Chairman and CEO, Freddie Mac, *Speech at the Regional Conference of MBAs, General Session* (New Jersey: March 20, 2002).

23. Alan Greenspan, *Mortgage Markets and Economic Activity: Remarks Before a Conference of Mortgage Markets and Economic Activity sponsored by America's Community Bankers* (Washington, D.C.: November 2, 1999).

24. Equivalent payments by homeowners are called "imputed rent." Imputed rent is best thought of as the equivalent rent payment an owner would have to make if they rented a unit of comparable quality and in a comparable home to the one they own.

25. Calculations based on the National Association of Home Builders (NAHB), *The Local Impact of Home Building in Average City, USA* (Washington, D.C.: February 2002). National aggregates calculated by the Millennial Housing Commission using 2001 Housing Start data from the U.S. Bureau of the Census.

26. NAHB estimates local effects of homebuilding by netting out impacts likely to accrue outside the local economy. New multifamily housing produced slightly fewer jobs and wages. Every 100 new multifamily apartments generates about 112 full-time equivalent local jobs, $5.3 million in local income, and $1.97 million in federal, state, and local tax revenues and fees in the first year alone.

27. NAHB, February 2002.

28. Federal Reserve, *Federal Flow of Funds Account, Fourth Quarter 2001* (Washington, D.C: Federal Reserve, March 2002).

America's Housing Challenges (pages 12 to 21)

1. The federal government has a variety of criteria for targeting and for eligibility. For the largest programs—Section 8 and public housing—the aid is focused on ELI and VLI households. Therefore this number is based on 4.8 million assisted units and 13.3 million ELI and VLI renter households.

2. Meryl Finkel, et al, *Status of HUD-Insured (or Held) Multifamily Rental Housing in 1995* (Prepared for the U.S. Department of Housing and Urban Development, May 1999).

3. In the case of renters, housing costs include the cost of utilities whether or not they pay for them separately. In the case of owners, costs include mortgage payments, taxes, insurance, and utilities.

4. Rameswar P. Chakrabarty, *American Housing Survey: A Quality Profile* (Washington, D.C.: U.S. Department of Housing and Urban Development, Bureau of the Census, H121/95-1, July 1996).

5. The overwhelming majority of worst-case needs problems stem from affordability, and it is relatively uncommon to have an adequacy problem without also having an affordability problem.

6. Michael A. Stegman, Roberto G. Quercia, and Walter Davis, *The Earned Income Tax Credit as an Instrument of Housing* (Chapel Hill: University of North Carolina, forthcoming 2002).

7. Zhu Xiao Di and Eric Belsky, *How Great are the Nation's Worst Case Housing Needs? A Plea for Cautious Interpretation* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, April 2002).

8. An alternative method of measuring housing affordability would be to calculate how much income a household has available to cover their housing costs after meeting other basic needs. This residual approach has a special traction when gauging the extent of housing affordability problems at the two extremes of the income distribution. Among many of those with extremely low incomes (defined as households with incomes at 30 percent or less of area medians), even spending 30 percent may be a serious hardship. Conversely, among those with middle and higher incomes (defined as households with incomes above 120 percent of area medians), spending 30 percent or more may not be a hardship at all.

9. Barbara J. Lipman, et al, *Paycheck to Paycheck: Working Families and the Cost of Housing in America* (Washington, D.C.: Center for Housing Policy and the National Housing Conference, June 2001).

10. It is worth noting that affordability measures are based on the top end of each income range. By definition, then, many units considered affordable to households in a particular income range are in fact not affordable to those at the middle or bottom of that range. In addition, comparisons of supply and demand are based simply on a count of households and units in each income range. These comparisons therefore ignore all of the critical factors—such as location, size, quality, and availability—necessary to equate housing demand and housing supply.

11. Charlie Wilkins, *Policy Option Paper: Issue: Production of Units for ELI Households (with incomes below 30% of AMI)* (Washington D.C.: Prepared for the Millennial Housing Commission, September 23, 2001).

12. Jack Goodman, *Housing Affordability in the United States: Trends, Interpretations and Outlook* (Washington, D.C.: Prepared for the Millennial Housing Commission, November 2001).

13. Charlie Wilkins, *Financial Modeling Summary* (Washington, D.C.: Prepared for the Millennial Housing Commission, 2001).

14. These special risks include cash flows that are typically close to break-even points, permit delays and restrictions resulting from community resistance to affordable housing, and risks that special waivers of zoning, subdivision, or code rules required to lower costs to affordable levels will not be granted.

15. U.S. Department of Commerce and the U.S. Department of Housing and Urban Development, *1999 American Housing Survey* (Washington, D.C., October 2000).

16. Ann B. Schnare, *Impact of Recent Trends in Multifamily Housing Finance on Older Urban Areas* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, June 2001).

17. These fees can be very high. In the San Francisco Bay area, for example, development impact fees are as high as $65,000 per new owner-occupied unit and over $40,000 per new rental unit. Wendell Cox, *Smart Growth and Housing Affordability* (Washington, D.C.: Prepared for the Millennial Housing Commission, March 2002).

18. The following findings emerge from the literature:

    - Exclusionary zoning artificially restricts the supply of land and leads to higher housing prices. See William A. Fischel, *Do Growth Controls Matter? A Review of Empirical Evidence on the Effectiveness and Efficiency of Local Government Land Use Regulation* (Cambridge, MA: Lincoln Institute for Land Policy, 1990). Bruce W. Hamilton, "Zoning and the Exercise of Monopoly Power," *Journal of Urban Economics 5* (1978): 116-130. Louis A. Rose, "Urban Land Supply: Natural and Contrived Restrictions," *Journal of Urban Economics 25* (1989): 325-345. James A. Thorson, "An Examination of the Monopoly Zoning Hypothesis," *Land Economics 72:1* (1996): 43-55. Henry Pollakowski and Susan M. Wachter, "The Effects of Land-Use Constraints on Housing Prices," *Land Economics 66:3* (1990): 315-324. Susan M. Wachter and Man Cho, "Interjurisdictional Price Effects of Land Use Controls," *Journal of Urban & Contemporary Law 40* (1991): 49-63. Richard K. Green, "Land Use Regulation and the Price of Housing in a Suburban Wisconsin County." *Journal of Housing Economics 8* (1999): 144-159.

    - Exactions and impact fees drive up housing costs directly for new construction, but also indirectly for existing housing. See Larry D. Singell and Jane H. Lillydahl, "An Empirical Examination of the Effect of Impact Fees on the Housing Market," *Land Economics 66:1* (1990): 82-91. Marla Dresch and Steven M. Sheffrin, *Who Pays for Development Fees and Exactions?* (San Francisco: Public Policy Institute of California, June 1997). Brett M. Baden and Don L. Coursey, *An Examination of the Effect of Impact Fees on Chicago's Suburbs* (Chicago: Irving B. Harris Graduate School of Public Policy Studies, University of Chicago, 2001). See also Mark Skidmore and Michael Peddle, "Do Development Impact Fees Reduce the Rate of Residential Development?" *Growth and Change 29* (Fall 1998): 383-400.

    - Growth controls lift prices and rents. See Lawrence Katz and Kenneth Rosen, "The Interjurisdictional Effects of Growth Controls on Housing Prices," *Journal of Law and Economics 30* (1987): 149-160. Ned Levine, "The Effects of Local Growth Controls on Regional Housing Production and Population Redistribution in California," *Urban Studies 36* (1999): 2047-2068. Wendell Cox and Ronald D. Utt, "Smart Growth, Housing Costs and Homeownership," *The Heritage Foundation Backgrounder 1426* (April 6, 2001). Samuel R. Staley and Gerard C. S. Mildner. "Urban-Growth Boundaries and Housing Affordability: Lessons From Portland*," Reason Public Policy Institute, Policy Brief 11* (1999). G. Donald Jud and Daniel T. Winkler, "The Dynamics of Metropolitan Housing Prices," *Journal of Real Estate Research 23:1/2* (2002): 29-45. A recent study using an index of restrictive regulations concluded that rents are 17 percent higher, house values 51 percent higher, and homeownership rates 10 percentage points lower, all else equal, in heavily regulated metropolitan areas. See Richard K. Green and Stephen Malpezzi, *A Primer on US Housing Markets and Housing Policy* (Madison: Center for Urban Land and Economics Research, University of Wisconsin, Working Paper Series, October 4, 2000). Note that this paper's index measure captures qualitative assessments of zoning and subdivision approval times, rezoning times, acreage of land zoned for single-family and multifamily housing in relationship to demand for them, percent of zoning changes approved, and adequacy of road and sewers. Another paper concluded that permit approval delays and growth control restrictions sharply reduce construction levels. See Christopher J. Mayer and C. Tsuriel Somerville, "Land Use Regulation and New Construction." *Regional Science & Urban Economics 30* (2000): 639-662.

19. Nearly a quarter of the stock was classified as "distressed," meaning that annual backlog-adjusted cash flow deficits exceeded $250 per unit. These properties' operating and physical needs would significantly outstrip available revenues and reserves. See Meryl Finkel, et al, *Status of HUD-Insured (or Held) Multifamily Rental Housing in 1995* (Washington, D.C.: Prepared for the U.S. Department of Housing and Urban Development, May 1999).

20. For example, HUD's reserve requirements on rent-restricted properties were based on practices used in underwriting unsubsidized properties, even though the latter depend on rent increases in excess of operating costs (in addition to adequately funded reserve accounts) to fund major system upgrades.

21. Joint Center for Housing Studies, *State of the Nation's Housing 2001* (Cambridge, MA: Harvard University, 2001).

22. Howard Savage, "Who Can Afford to Buy a House In 1995?" *Current Housing Reports, U.S. Census Bureau* (August 1999). Stuart S. Rosenthal, "Eliminating Credit Barriers to Increase Homeownership: How Far Cab We Go?" *Low-Income Homeownership: Examining the Unexamined Goal* (Washington, D.C.: Brookings Press, expected 2002). Peter Linneman and Susan Wachter, "The Impacts of Borrowing Constraints on Homeownership," *AREUEA Journal* 17:4 (1989): 389-402.

23. From special tabulations created by the Federal Housing Finance Board for the Joint Center for Housing Studies of Harvard University.

24. These figures are based on the Current Population Survey. The 2000 Census shows lower overall homeownership rates but similarly wide gaps in homeownership rates between whites and minorities and high and low-income households.

25. Joint Center for Housing Studies, *State of the Nation's Housing 2000* (Cambridge, MA: Harvard University, 2000).

The Federal Role in Housing (pages 22 to 26)

1. Eugene J. Meehan "The Evolution of Public Housing Policy," *Federal Housing Policy and Programs: Past and Present* (Rutgers University: Center for Urban Policy Research, 1985).

2. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2002-2006* (Washington, D.C., January 17, 2002).

Principal Recommendations to Congress: A Framework for Change (pages 27 to 63)

1. Andrew Reschovsky, Robert M. La Follette, and Richard K. Green, "Tax Credits and Tenure Choice," *Proceedings of the 91st Annual Conference on Taxation* (Washington, D.C.: National Tax Association, 1999).

2. Abdighani Hirad and Peter Zorn, *A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling* (Washington, D.C.: Freddie Mac, May 21, 2001).

3. Projects financed under Sections 202 and 811 are categorically ineligible for prepayment or opt out.

4. HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

5. The history of subsidized rental housing programs demonstrates that annual inflation adjustment is superior to approaches based on project-specific operating costs. In theory, the inflation factor should be related to operating costs, but this has proven difficult in practice.

6. Thrifty production vouchers, a new kind of project-based subsidy currently under consideration by Congress, differ from regular vouchers in that their "payment standard" would be equal to unit operating costs rather than some percentage of Fair Market Rent.

7. Housing choice voucher holders may pay up to 40 percent of their income for rent, so this provision would effectively limit them to units where the rent is at or moderately higher than the applicable voucher payment standard. The standard is set by the applicable PHA and is between 90 and 110 percent of the FMR, unless HUD approves an exception.

8. *The Final Report of the National Commission on Severely Distressed Public Housing, A Report to the Congress and the Secretary of HUD* (Washington, D.C.: August 1992).

9. Meryl Finkel et al., *Capital Needs of the Public Housing Stock in 1998: Formula Capital Study* (Washington, D.C.: Prepared for the U.S. Department of Housing and Urban Development, January 30, 2000).

10. Funded by annual appropriations.

11. For PHAs with individual scattered-site homes in their inventory, a "property" is probably a group of such homes located near one another, rather than a "project" as defined by HUD.

12. An instrument similar to that used in the Mark-to-Market process could be employed for these assessments, which would also benefit from the significant planning already conducted by many PHAs.

13. As units become vacant.

14. This approach will not work in locations where lack of affordable private rental housing makes vouchers unusable. It is particularly unlikely to work for small rural PHAs.

15. For information on the characteristics of high poverty neighborhoods, see: Sandra J. Newman and Ann B. Schnare, "'...And a Suitable Living Environment': The Failure of Housing Programs to Deliver on Neighborhood Quality," *Housing Policy Debate* 8:4 (1997): 703-742. Paul Jargowsky, *Poverty and Place: Ghettos, Barrios, and the American City* (New York: Russell Sage Foundation, 1997).

16. For more details on this proposal see James G. Stockard, Gregory A. Byrne, et al. *Public Housing Operating Cost Study* (Cambridge, MA: Harvard University, Graduate School of Design, 2001).

17. That is, properties that, once investments are complete, would have market rents capable of supporting the debt service needed to bring them to adequate condition.

18. U.S. Department of Housing and Urban Development, *Resident Characteristics Report for Public Housing* (October 2000).

19. FHA Comptroller's Report to the Commissioner, *FHA Portfolio Analysis: Data as of September 2001* (Washington, D.C., October 2001). Office of the President of the United States, *Budget of the U.S. Government, FY 2003, Appendix* (Washington, D.C.: January 2002).

20. Passed in 1945, the GCCA is the legislation under which wholly owned government corporations are chartered. These include a large number of entities that support themselves through their own revenues.

21. These include equity pay-in rules that make FHA insurance difficult to use with Low Income Housing Tax Credits, a developer's profit calculation (called BSPRA), a cost-certification process that has limited relevance in today's market, and overly complex and costly rules for oversight of wage rate requirements.

22. A properly designed risk-sharing program would rely upon the strengths of the respective partners and have controls to assure partners selected are well capitalized and able to honor risk-sharing commitments. The target market for any program would need to be well understood, including how it related to FHA's current programs and those markets that are already well served by the private sector. The risk-sharing agreement would also need to properly align incentives so that the partner would be motivated to protect FHA against inappropriate losses. See Sarah Rosen Wartell, *Single-Family Risk-Sharing: An Evaluation of its Potential as a Tool for FHA* (Washington, D.C.: Prepared for the Millennial Housing Commission, May 2002).

23. In particular, some believe that there is an important expanded role for FHA to play in the growing subprime mortgage market, but few believe that FHA today has the risk management and delivery systems in place to insure those higher risks prudently. On the other hand, there are potential partners who have the technology, skills, and systems to manage risk, but not the capital or risk tolerance for the subprime market. Risk-sharing with these actors would allow FHA to rationalize underwriting, promote transparency, reduce predatory practices, and enhance price competition in the subprime market.

24. There are several ways in which FHA can mitigate risks in the program. Two-party checks for any disbursement of funds, endorsed by both the borrower and the contractor, for example, might help keep contractors from defrauding homeowners. Requiring frequent property inspections with strict standards also might help ensure loans are appropriate. Do-it-yourself borrowers should face additional scrutiny. In addition, the mortgage insurance premium should be adjusted to reflect program costs and risks.

25. Martha R. Burt, *What Will it Take to End Homelessness?* (Washington D.C.: Urban Institute, September 2001).

26. Ibid.

27. Dennis Culhane, et al., *The Prevalence of Homelessness 1998: Results from the Analysis of Administrative Data in 9 U.S. Jurisdictions* (Philadelphia: University of Pennsylvania, May 2000).

28. Dennis P. Culhane, Stephen Metraux, and Trevor Hadley, *The Impact of Supportive Housing for Homeless People with Severe Mental Illness on the Utilization of the Public Health, Corrections and Emergency Shelter Systems: The New York-New York Initiative* (Philadelphia: Center for Mental Health Policy and Services Research, University of Pennsylvania, May 2001).

29. The most recent evaluation of the Minnesota Family Investment Program (MFIP) found that the MFIP welfare reform intervention had a greater impact on families living in subsidized housing than on those living in private-market housing. For families living in subsidized housing, MFIP's impact on employment rates was 17.9 percentage points, compared to 7.9 percentage points for families in private-market housing. Cynthia Miller, et al., *Reforming Welfare*

and Rewarding Work: Final Report on the Minnesota Family Investment Program (New York: Manpower Demonstration Research Corporation, 2001).

30. The *utilization rate* is defined as the percentage of available vouchers that the PHA has under lease or the percentage of its annual budget authority that it has spent. The *success rate* is the percentage of families provided vouchers who lease a unit meeting the program requirements within the allotted amount of time. Both utilization rates and success rates are declining in the voucher program and in some places are unacceptably low.

31. The causes of low utilization and success rates are not well understood. Research to date suggests little relationship between market conditions and low *utilization rates* by PHAs. *Success rates* also vary widely among PHAs, and some PHAs operating in tight rental markets nonetheless have high success rates. In general, however, relatively low success rates are associated with low rental vacancy rates at those rent levels affordable to households with vouchers.

32. This would maintain the intent of the cap while giving families access to some units in better neighborhoods that they are not now permitted to rent.

33. The regulations governing project-basing in the voucher program were recently substantially revised to increase the percentage of tenant-based funds that PHAs can project-base and expand the range of properties eligible for project-basing. At the same time, the regulations limit the proportion of units in a building that may receive project-based assistance and require PHAs to provide tenant-based assistance to families who wish to leave project-based units. HUD has also implemented the statutory requirement on deconcentration of poverty by requiring that all new project-based units be located in census tracts with poverty rates of less than 20 percent.

34. John Goering, Judith Feins, et al., *Moving to Opportunity for Fair Housing Demonstration Program: Current Status and Initial Findings* (Washington, D.C.: U.S. Department of Housing and Urban Development, Abt Associates, and Computer Based Systems Incorporated, September 1999).

35. Barbara Sard, *The Family Self-Sufficiency Program: HUD's Best Kept Secret for Promoting Employment and Asset Growth* (Washington, D.C.: Center on Budget and Policy Priorities, April 2001).

36. According to the National Council of State Housing Agencies, "a majority [of apartments produced under the program] is dedicated for periods longer than 30 years, and several are permanently dedicated to low income use" (http://www.ncsha.org/).

37. Catalog of Federal Domestic Assistance (http://www.cfda.gov/). Program Number 14.239.

38. National Council of State Housing Agencies, *Ten Year Rule Impact on MRB Mortgage Lending, 2001-2005* (2001).

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Appendix 1 | *Supporting Data*

Table 1 | *Household and Housing Stock Characteristics by Income, 1999 (Thousands)*

	Owners				
	ELI (1)	**VLI**	**LI**	**MI**	**HI**
Households					
Total Households	6,410	7,138	10,680	14,284	30,283
Not Burdened (0-30%) (2)	1,854	4,259	7,571	11,888	28,701
Moderately Burdened (30-50%)	1,372	1,728	2,328	1,931	1,344
Severely Burdened (>50%)	3,175	1,151	783	465	239
Working Status of Households					
Earning at Least FTE Minimum Wage	393	2,647	7,024	11,478	28,136
Number with Severe Cost Burdens	167	582	564	383	217
Earning Between Half and FTE Minimum Wage	598	515	495	180	204
Number with Severe Cost Burdens	268	96	28	5	-
Earning Less than Half FTE Minimum Wage	703	355	349	210	156
Number with Severe Cost Burdens	514	59	25	16	2
Elderly, Not Working	3,188	3,086	2,396	1,678	1,306
Number with Severe Cost Burdens	1,392	290	118	32	7
Non-elderly, Not Working	1,528	537	416	738	481
Number with Severe Cost Burdens	843	124	46	29	13
Affordable Housing Stock					
Units Affordable at 30% of Income	6,606	11,669	23,475	17,053	11,445
Affordable and Available	1,724	3,778	7,322	6,324	11,445
Gap between Available Units and Households	(4,686)	(3,360)	(3,358)	(7,960)	(18,838)
Adequate	5,586	10,602	22,280	16,440	10,962
Moderately Inadequate	511	548	539	289	169
Severely Inadequate	168	171	302	161	67
Vacant: No Information	341	347	354	163	247

Notes:

1. ELI (extremely low income) defined as having incomes below 30% of AMI; VLI (very low income) defined as having incomes 30-50% of AMI; LI (low income) defined as having incomes 50-80% of AMI; MI (moderate income) defined as having incomes 80-120% of AMI; HI (high income) defining as having incomes over 120% of AMI.
2. Households in the “not burdened” group include those reporting zero or negative income. Depending on their reported housing costs, the households were included in ELI or MI.

Source: HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

		Renters			
ELI	VLI	LI	MI	HI	Total
8,513	6,243	7,270	6,681	5,300	102,802
2,134	2,172	5,034	6,092	5,174	74,879
1,580	2,950	1,984	496	110	15,823
4,798	1,121	252	93	15	12,092
1,110	4,452	6,603	6,056	5,108	73,007
482	679	197	82	8	3,361
1,631	606	131	22	19	4,401
984	130	2	-	2	1,515
1,710	146	57	15	17	3,718
1,311	43	5	-	-	1,975
1,721	749	377	197	100	14,798
898	181	42	12	5	2,977
2,340	291	102	389	55	6,877
1,124	88	7	-	-	2,274
6,681	12,092	14,222	2,950	1,073	107,266
3,570	6,631	7,231	1,645	1,073	50,743
(4,943)	388	(39)	(5,036)	(4,227)	(52,059)
5,288	9,598	11,845	2,483	840	95,924
609	1,116	867	121	56	4,825
330	397	381	61	15	2,053
454	981	1,129	285	162	4,463

Table 2 | *Affordable Rental Stock by Income Group, 1985-1999 (Thousands)*

	ELI	VLI	LI		MI		HI	Total
	under 30%	30-50%	50-60%	60-80%	80-100%	100-120%	over 120%	
1985	6,285	9,392	5,888	8,053	3,832	1,194	502	35,146
1995	6,633	9,936	6,998	8,388	3,545	990	434	36,924
1999	6,681	12,092	6,948	7,274	2,271	678	1,073	37,017
Change in Units								
1985-1999	396	2,700	1,060	(779)	(1,561)	(516)	571	1,871

Notes: Units are classified by comparing their rents (adjusted for number of bedrooms) to the rent affordable in local markets to households with incomes at the upper and lower threshold incomes of the group. For example, units with monthly gross rents that are 30% of monthly incomes between 30% and 50% of AMI are classified as affordable to very low-income households. Income cutoffs are determined by deflating/inflating 1995 HUD Income Limits for general price inflation and real income growth.

Source: HUD tabulations of the American Housing Survey prepared for the Millennial Housing Commission.

Table 3 | *Stock of Federally Assisted Units by Funding Source, 1999*

	Thousands of Units
Inactive: Publicly Owned, Project-Based	
Public Housing	1,274
Inactive: Privately Owned, Project-Based	
Section 8 New Construction / Substantial Rehabilitation	644
Section 202 Elderly Housing Direct Loan	207
Section 8 Property Disposition	60
Section 8 Loan Management Set-Aside	409
Rent Supplement	21
Section 236	60
Section 221(d)(3) Below Market Interest Rate	71
Active: Tenant-Based	
Section 8 Certificates and Vouchers	1,581
Active: Privately Owned, Project-Based	
Section 202 Supportive Housing for the Elderly	65
Section 811 Supportive Housing for Persons with Disabilities	18
Section 515 Rural Housing Rental Assistance	410
Total: Rental Assistance	**4,820**
Total: Owner Assistance	**591**
Total: Direct Assistance	**5,411**

Note: Numbers are adjusted for overlap based on HUD's *A Picture of Subsidized Households, 1998*, RHS data, and GAO's *Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program*, GAO/GGD/RCED-97-55.

Sources: GAO, *Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs*, GAO-02-76; HUD Budget Office; Rural Housing Service, Deputy Administrator for Single-Family Housing; and U.S. House of Representatives, *2000 Green Book*.

Table 4 | ***Selected Household Characteristics by Tenure and Percent of Area Median Income, 1999 (Millions)***

Percent of Area Median Income	Households		Median Household Income		Median Monthly Housing Cost
	Number	Percent	Total Reported Income	Amount Affordable for Housing at 30%	
Renter Households					
Under 30%	8.5	25	$7,000	$175	$426
30-50%	6.2	18	$17,000	$425	$509
50-80%	7.3	21	$26,541	$664	$565
80-120%	6.6	19	$40,000	$1,000	$643
Over 120%	5.3	16	$68,000	$1,700	$736
All	34.0	100	$24,400	$610	$560
Owner Households					
Under 30%	6.4	9	$6,500	$163	$300
30-50%	7.1	10	$15,613	$390	$324
50-80%	10.7	16	$27,000	$675	$453
80-120%	14.3	21	$41,200	$1,030	$633
Over 120%	30.3	44	$81,000	$2,025	$908
All	68.8	100	$45,400	$1,135	$617
All Households					
Under 30%	14.9	15	$7,000	$175	$369
30-50%	13.3	13	$16,000	$400	$426
50-80%	18.0	18	$27,000	$675	$520
80-120%	20.9	20	$40,050	$1,001	$637
Over 120%	35.6	35	$79,000	$1,975	$865
All	102.7	100	$36,000	$900	$585

Source: HUD tabulations of the 1999 American Housing Survey prepared for the Millennial Housing Commission.

Median Housing Cost as Percent of Income	Housing Costs					
	Under 30% of Income		30-50% of Income		Over 50% of Income	
	Number	Percent	Number	Percent	Number	Percent
58	2.1	25	1.6	18	4.8	56
35	2.2	35	3.0	48	1.1	18
25	5.0	69	2.0	27	0.3	3
19	6.1	92	0.5	8	0.1	1
12	5.2	98	0.1	2	0.0	0
25	20.6	61	7.2	21	6.3	18
50	1.9	29	1.4	21	3.2	50
25	4.3	60	1.7	24	1.2	16
21	7.6	71	2.3	22	0.8	7
17	11.9	83	1.9	14	0.5	3
13	28.7	95	1.3	4	0.2	1
17	54.4	79	8.6	13	5.9	8
54	4.0	27	3.0	20	8.0	54
31	6.5	48	4.7	35	2.3	17
23	12.6	70	4.3	24	1.1	6
18	18.0	86	2.4	12	0.6	3
13	33.9	95	1.4	4	0.2	1
19	75.0	73	15.8	15	12.2	12

Table 5 | ***Homeownership Rates by Race and Ethnicity of Householder, 1983-2001 (Percent)***

	U.S. Total	Total White	Non-Hispanic White	Total Black	Other	American Indian, Aleut, Eskimo	Asian or Pacific Islander	Other	Hispanic
1983	64.9	n/a	69.1	45.6	53.3	n/a	n/a	n/a	41.2
1984	64.5	n/a	69.0	46.0	50.9	n/a	n/a	n/a	40.1
1985	64.3	n/a	69.0	44.4	50.7	n/a	n/a	n/a	41.1
1986	63.8	n/a	68.4	44.8	49.7	n/a	n/a	n/a	40.6
1987	64.0	n/a	68.7	45.8	48.7	n/a	n/a	n/a	40.6
1988	64.0	n/a	69.1	42.9	49.7	n/a	n/a	n/a	40.6
1989	64.0	n/a	69.3	42.1	50.6	n/a	n/a	n/a	41.6
1990	64.1	n/a	69.4	42.6	49.2	n/a	n/a	n/a	41.2
1991	64.0	n/a	69.5	42.7	51.3	n/a	n/a	n/a	39.0
1992	64.1	n/a	69.6	42.6	52.5	n/a	n/a	n/a	39.9
1993	64.1	n/a	70.2	42.0	50.6	n/a	n/a	n/a	39.4
1994	64.2	67.7	70.0	42.3	47.7	51.7	51.3	36.1	41.2
1995	64.7	68.7	70.9	42.7	47.2	55.8	50.8	37.4	42.1
1996	65.4	69.1	71.7	44.1	51.0	51.6	50.8	n/a	42.8
1997	65.7	69.3	72.0	44.8	52.5	51.7	52.8	n/a	43.3
1998	66.3	70.0	72.6	45.6	53.0	54.3	52.6	n/a	44.7
1999	66.8	70.5	73.2	46.3	53.7	56.1	53.1	n/a	45.5
2000	67.4	71.1	73.8	47.2	53.5	56.2	52.8	n/a	46.3
2001	67.8	71.6	74.3	47.7	54.2	55.4	53.9	n/a	47.3

Note: Breakdowns of "other races" are not available before 1994. Starting in 1996, all "other races" were added into one of two existing categories.

Source: U.S. Bureau of the Census.

Table 6 | *Households Receiving Direct Housing Assistance Administered by HUD, 1977-2000*

	Assisted Renters					
	Existing Housing					
	Tenant-Based (1)	Project-Based (2)	New Construction (3)	Total Assisted Renters (4)	Total Assisted Homeowners (5)	Total Assisted Households
1977	162	105	1,799	2,067	331	2,398
1978	297	126	1,928	2,350	293	2,643
1979	427	175	1,978	2,580	262	2,842
1980	521	185	2,090	2,797	235	3,032
1981	599	221	2,228	3,212	219	3,431
1982	651	194	2,373	3,379	241	3,620
1983	691	265	2,485	3,615	242	3,857
1984	728	357	2,589	3,851	230	4,081
1985	749	431	2,657	4,015	210	4,225
1986	797	456	2,686	4,135	200	4,335
1987	893	473	2,721	4,279	182	4,461
1988	956	490	2,736	4,371	159	4,530
1989	1,025	509	2,748	4,485	148	4,633
1990	1,090	527	2,755	4,569	141	4,710
1991	1,137	540	2,778	4,656	130	4,786
1992	1,166	554	2,786	4,705	125	4,830
1993	1,326	574	2,762	4,861	98	4,959
1994	1,392	593	2,764	4,939	95	5,034
1995	1,474	607	2,778	5,049	80	5,129
1996	1,413	608	2,817	5,028	76	5,104
1997	1,465	586	2,822	5,063	68	5,131
1998	1,481	564	2,786	5,021	60	5,081
1999	1,613	542	2,757	5,101	53	5,154
2000	1,621	522	2,728	5,061	43	5,104

Notes:
1. Includes units assisted with Section 8 certificates and vouchers.
2. Includes units assisted through the Section 8 Loan Management Set Aside, PD, Conversion (from rent supplement and Section 236 Rental Assistance Program), and Moderate Rehabilitation Programs.
3. Includes units assisted through the Section 8 New Construction and Substantial Rehabilitation Program, Section 236, Rent Supplement, and Public Housing Programs (including Indian units constructed under Public Housing but now assisted through the other programs).
4. The total number of assisted renters has been adjusted since 1980 to avoid double-counting of households receiving more than one type of subsidy. The total number therefore is lower than the sum of the components.
5. Includes units assisted through various Section 235 programs.

Source: *2000 Green Book: Background Material and Data on Programs within the Jurisdiction of the Committee of Ways and Means*, U.S. House of Representatives, October 6, 2000.

Table 7 | *Number of Units Eligible for Assisted Housing Payments by Program, 1957-2000 (Thousands)*

		Section 515			Section 236					
	Public Housing	**Total**	**With Section 8**	**Rent Supplement**	**Total**	**With Rent Supplement or Section 8**	**Tenant-Based**	**New Subrehab (1)**	**Other Project-Based (2)**	**LIHTC**
1957	366	0	0	0	0	0	0	0	0	0
1958	374	0	0	0	0	0	0	0	0	0
1959	401	0	0	0	0	0	0	0	0	0
1960	425	0	0	0	0	0	0	0	0	0
1961	465	0	0	0	0	0	0	0	0	0
1962	483	n/a	0	0	0	0	0	0	0	0
1963	511	n/a	0	0	0	0	0	0	0	0
1964	540	n/a	0	0	0	0	0	0	0	0
1965	577	n/a	0	0	0	0	0	0	0	0
1966	609	n/a	0	0	0	0	0	0	0	0
1967	640	n/a	0	1	0	n/a	0	0	0	0
1968	687	n/a	0	3	0	n/a	0	0	0	0
1969	768	n/a	0	12	0	n/a	0	0	0	0
1970	830	n/a	0	31	5	n/a	0	0	0	0
1971	893	n/a	0	58	32	n/a	0	0	0	0
1972	989	n/a	0	92	99	n/a	0	0	0	0
1973	1,047	n/a	0	118	191	n/a	0	0	0	0
1974	1,109	n/a	0	148	294	n/a	0	0	0	0
1975	1,151	n/a	0	165	400	n/a	0	0	0	0
1976	1,172	26	0	174	447	n/a	162	6	105	0
1977	1,174	50	1	180	543	n/a	297	30	126	0
1978	1,173	81	7	172	545	n/a	427	89	175	0
1979	1,178	114	16	179	541	n/a	521	192	185	0
1980	1,192	151	24	165	538	163	599	333	221	0
1981	1,204	185	32	158	537	161	651	474	194	0
1982	1,224	217	40	153	537	175	691	571	265	0
1983	1,314	247	44	77	533	177	728	664	357	0
1984	1,341	274	45	56	531	178	749	730	431	0
1985	1,355	301	46	46	528	196	797	757	456	0
1986	1,380	326	46	34	529	192	893	778	473	0
1987	1,390	349	46	23	528	189	956	794	490	34
1988	1,398	368	46	23	528	203	1,025	799	509	116
1989	1,404	386	46	20	528	197	1,090	804	527	242
1990	1,405	402	46	20	531	200	1,137	823	540	316
1991	1,410	418	46	20	528	199	1,166	827	554	428
1992	1,409	434	46	20	510	199	1,326	822	574	519
1993	1,408	449	46	19	510	190	1,392	827	593	623
1994	1,409	464	46	19	505	190	1,487	845	595	740
1995	1,397	476	46	21	508	190	1,413	890	608	827
1996	1,389	483	46	21	505	190	1,465	907	586	902
1997*	1,372	483	46	21	494	190	1,499	880	564	972
1998*	1,295	483	46	21	476	190	1,606	854	542	1,041
1999*	1,274	485	45	21	464	n/a	1,581	851	n/a	1,104

* These numbers are estimates.

Notes: 1. Excludes units funded with capital grants and project rental assistance through the Section 202|811 program, but includes Section 202 Direct Loans.
2. Includes units receiving assistance through the Section 8 LMSA program, Property Disposition, Conversion (from Rent Supplement and Section 236 RAP), and Moderate Rehabilitation programs.

Sources: 1957-1998: Edgar O. Olson, *Housing Programs for Low-Income Households*, National Bureau of Economic Research, April 2001. 1999*: Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs*, GAO-02-76. LIHTC numbers: Estimates by Recapitalization Advisors in a paper prepared for the Millennial Housing Commission.

Table 8 | *Key Federal Housing Budget Trends (Billions of Constant 2002 Dollars)*

Federal Spending for Housing	1977-1981	1982-1986	1987-1991	1992-1996	1997-2001	2002-2007
Assisted Housing Outlays	$4.9	$13.5	$14.9	$23.7	$28.6	$33.8
Assisted Housing Budget Authority	$28.1	$15.3	$12.0	$18.8	$18.6	$31.4
Tax Expenditures	$44.8	$63.7	$90.9	$107.5	$117.9	$120.2
All HUD Outlays	$10.1	$18.1	$19.4	$26.0	$31.1	$34.0
All HUD BA	$78.8	$33.3	$24.2	$27.9	$25.4	$35.2

Federal Tax Expenditures for Housing	1977-1981	1982-1986	1987-1991	1992-1996	1997-2001	2002-2007
Mortgage Interest Deductions	$25.2	$39.4	$49.6	$55.4	$60.0	$66.3
Property Tax Deductions	$14.5	$13.9	$13.9	$16.5	$21.3	$19.2
Capital Gains	$2.9	$3.9	$15.7	$21.8	$22.4	$20.1
Other Homeowner	$0.1	$0.9	$0.0	$0.0	$0.0	$0.0
Homeowner Subtotal	$42.7	$58.1	$79.3	$93.7	$103.6	$105.5
Investor Deductions	$2.1	$5.6	$11.6	$13.8	$14.3	$14.7
Total	$44.8	$63.7	$90.9	$107.5	$117.9	$120.2

Source: National Low Income Housing Coalition, *Changing Priorities: The Federal Budget and Housing Assistance, 1996-2006*, 2001.

Table 9 | *Housing Market Indicators, 1975-2001 (Thousands)*

	Permits		Starts			Home Sales	
Year	**Single-Family**	**Multifamily**	**Single-Family**	**Multifamily**	**Manufactured**	**New**	**Existing**
1975	676	264	892	268	229	549	2,476
1976	894	403	1,162	375	250	646	3,064
1977	1,126	564	1,451	536	258	819	3,650
1978	1,183	618	1,433	587	280	817	3,986
1979	982	570	1,194	551	280	709	3,827
1980	710	480	852	440	234	545	2,973
1981	564	421	705	379	229	436	2,419
1982	546	454	663	400	234	412	1,990
1983	902	704	1,068	636	278	623	2,719
1984	922	759	1,084	665	288	639	2,868
1985	957	777	1,072	670	283	688	3,214
1986	1,078	692	1,179	626	256	750	3,565
1987	1,024	510	1,146	474	239	671	3,526
1988	994	462	1,081	407	224	676	3,594
1989	932	407	1,003	373	203	650	3,346
1990	794	317	895	298	195	534	3,211
1991	754	195	840	174	174	509	3,220
1992	911	184	1,030	170	212	610	3,520
1993	987	213	1,126	162	243	666	3,802
1994	1,069	303	1,198	259	291	670	3,946
1995	997	335	1,076	278	319	667	3,812
1996	1,070	356	1,161	316	338	757	4,196
1997	1,062	379	1,134	340	336	804	4,382
1998	1,188	425	1,271	346	374	886	4,970
1999	1,247	417	1,302	339	338	880	5,205
2000	1,198	394	1,231	338	273	877	5,113
2001	1,222	390	1,275	328	n/a	900	5,251

Note: Single-family is defined as both attached and detached one-unit dwellings; multifamily as any structure with two or more units. Manufactured housing is defined as HUD-code housing.

Source: U.S. Bureau of the Census, *Construction Reports*, 1975-2001.

Table 10 | *Terms on Conventional Single-Family Mortgages, Annual National Averages, All Homes, 1980-2001*

Year	Effective Interest Rate (%)	Term to Maturity (Years)	Mortgage Loan Amount (1,000s of 2001 Dollars)	Purchase Price (1,000s of 2001 Dollars)	Loan To Price Ratio	Percent of Loans With	
						Loan-to-Price Ratio Above .9	Adjustable Rates
1980	12.8	27.2	111.1	157.8	72.9	10	n/a
1981	14.9	26.4	104.6	148.7	73.1	15	n/a
1982	15.3	25.6	100.9	143.9	72.9	21	41
1983	12.7	26.0	106.5	147.8	74.5	21	40
1984	12.5	26.8	109.9	147.6	77.0	27	62
1985	11.6	25.9	115.5	158.2	75.8	21	51
1986	10.2	25.6	128.1	178.7	74.1	11	30
1987	9.3	26.8	138.9	189.9	75.2	8	43
1988	9.3	27.7	145.8	197.0	76.0	8	58
1989	10.1	27.7	149.3	204.0	74.8	7	38
1990	10.1	27.0	140.9	193.2	74.7	8	28
1991	9.3	26.5	138.2	190.8	74.4	9	23
1992	8.1	25.4	137.2	184.8	76.6	14	20
1993	7.1	25.5	131.1	175.4	77.2	17	20
1994	7.5	27.1	131.3	169.7	79.9	25	39
1995	7.9	27.4	128.3	165.9	79.9	27	32
1996	7.7	26.9	134.0	175.1	79.0	25	27
1997	7.7	27.5	139.7	181.5	79.4	25	22
1998	7.1	27.8	143.2	188.4	78.9	25	12
1999	7.3	28.2	148.1	195.8	78.5	23	21
2000	8.0	28.7	152.5	204.6	77.8	22	24
2001	7.0	27.6	155.7	215.5	76.2	21	12

Source: Federal Housing Finance Board, Monthly Interest Rate Survey.

Appendix 2 | *Assumptions Used in Analyzing the American Housing Survey*

To approximate the extent of need, housing affordability, and cost burdens for this report, the Millennial Housing Commission worked with the U.S. Department of Housing and Urban Development to generate special tabulations of the 1985, 1995, and 1999 American Housing Surveys (AHS). The estimates cited in this report reflect the following assumptions and calculations.

Household Income Groups

The Commission used HUD-Adjusted Median Family Income (HAMFI) to define household income groups. Using this method, the HAMFI value was adjusted to establish cutoffs for extremely low-income (not exceeding 30 percent of area median income (AMI)), very low-income (30 to 50 percent of AMI), low-income (50 to 80 percent of AMI), middle-income (80 to 120 percent of AMI), and high-income (more than 120 percent of AMI) groups.

The first step was to estimate income cutoffs for the three years examined. To do this, the MHC chose to use published 1995 HAMFI cutoffs for all three years and then adjust for both inflation and real income growth to approximate 1985 and 1999 cutoffs.

While almost all households can be grouped using this simple method, additional criteria are necessary for those with zero or negative income. Households reporting zero or negative income and housing costs greater than or equal to the fair market rent (FMR) for their areas were included in the middle-income group. Those with housing costs below FMR were considered extremely low-income households.

Households were sorted by how their income compared with the HAMFI cutoffs. Household income includes wages and salaries, business income, social security and pensions, interest income, stock dividends, rental income, welfare or SSI payments, alimony or child support, and "other income," such as worker's compensation and unemployment payments. This measurement is before tax or other deductions.

Housing Costs

Real housing costs were examined for each record in the AHS. For renters, housing cost is defined as rent plus utilities as reported by each survey respondent. For owners, housing cost includes reported mortgage payments, taxes, insurance, and utility payments. These are the real housing costs for each household.

Households who reported paying no cash rent were included in the appropriate income group and labeled as having no housing costs.

Cost Burdens

To determine the extent and severity of affordability problems in America, the MHC calculated the ratio of income to housing costs for each household surveyed. Households were then grouped by these ratios to determine the extent of their cost burdens. A household is considered moderately cost-burdened if it pays between 30 percent and 50 percent of income for housing. A household is considered severely cost-burdened if it pays more than 50 percent of income for housing.

Again, households reporting zero or negative income were treated separately. Regardless of their income grouping, the Commission considered these households not burdened for purposes of this report (i.e., paying less than 30 percent of income for housing). This was done to ensure a more conservative estimate of the extent of housing affordability problems since there is no way to discern which of these households may be cost-burdened. Households who reported paying no cash rent were also considered to have no housing cost burden.

Affordable Units by Income Range

Each unit included in the American Housing Survey was placed into an affordability category by comparing its gross rent or estimated ownership cost (described below) to the household income cutoffs noted above. A unit was considered affordable to an income group if the gross rent or estimated ownership cost fell between 30 percent of the monthly income that demarcated the top and bottom of the income group. To approximate the actual number of affordable units, the Commission excluded those identified as “seasonal” or “usual residence elsewhere” (URE), which are typically second homes and unavailable to households seeking affordable housing.

To sort units by income group, the Millennial Housing Commission attempted to include all housing costs in the measurement. To this end, utility costs for vacant units had to be imputed or allocated. These allocations are based on four factors: monthly housing costs (rent or mortgage payment), structure type (single- or multifamily), region of the country (census region), and tenure (owner or renter).

Reported monthly principal and interest payments for owner-occupied units varied widely and therefore did not correlate well with property values. To standardize owner-occupied housing costs, the MHC assumed a 30-year mortgage with a 7-percent interest rate as well as a 10-percent downpayment, plus the cost of utilities, taxes, and insurance.

The final calculation to ensure that housing units were grouped appropriately was to adjust the threshold for affordable rents by bedroom size. The following adjustments were made to reflect the size of the households that would occupy the unit:

0 bedrooms: AMI * 0.70
1 bedroom: AMI * 0.75
2 bedrooms: AMI * 0.90
3 bedrooms: AMI * 1.04
4 bedrooms: AMI * 1.16
5 bedrooms: AMI * 1.28
6 bedrooms: AMI * 1.40
7+ bedrooms: AMI * (1.40 + 0.12 per bedroom over 6)

Earnings Classifications

The Millennial Housing Commission was also interested in determining the working status of households. To this end, households were first sorted by total household income. Wage and salary earnings within each income group were then calculated, and households were again sorted into four groups: those with zero wage earnings, less than half the full-time equivalent of minimum wage, half- to full-time minimum wage, or greater than minimum wage. Households were then classified by cost burden, based on housing costs relative to total household income.

Household groups were also sorted by age to identify which were elderly (65 or older) and non-elderly (younger than 65). To examine the cost burdens and characteristics of some working households, a second set of tabulations was run using salary cutoffs based on the average incomes of several professions.

Appendix 3 | *Description of Housing Programs*

Public Housing

Public Housing

Enactment: U.S. Housing Act of 1937

Program Description: Full subsidy of capital costs and those operating costs of public housing that exceed tenant rent billed up to an allowable expenses level. Subsidy paid to local public housing authority (PHA).

Tenant Eligibility: Income lower than 80% of area median, adjusted for family size. Forty percent of new admissions every year must have incomes below 30% of area median. Local PHAs may apply further prioritizing criteria, such as family size or type, age, employment status, and income based on local housing need.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of monthly adjusted income for rent, or a minimum rent (up to $50) set by the housing authority.

Number of Existing Units: 1,273,500

FY 2001 Budget Authority: $3,000,000,000 (Capital Fund), $3,242,000,000 (Operating Fund), $310,000,000 (Drug Elimination Grants)

FY 2001 Outlays: $3,550,000,000 (Capital Fund), $3,137,000,000 (Operating Fund), $310,000,000 (Drug Elimination Grants)

Current Status: Funding for public housing development stopped in 1995 when Congress rescinded the final development funds appropriated. PHAs were permitted to use capital funds for new housing development, but funding was not increased. The public housing stock reached its peak in 1991 (1,410,137 units).

Revitalization of Severely Distressed Public Housing (HOPE VI)

Enactment: U.S. Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 1993

Program Description: Project-specific grants to PHAs to demolish, rehabilitate or replace distressed public housing units while promoting mixed-income communities. Units may be privately owned and managed, and some may be market-rate rentals or affordable homeownership.

Tenant Eligibility: The same as public housing for units receiving public housing subsidy.

Rent Structure: Units receiving public housing subsidy have public housing rents.

Number of Existing Units: 14,554 as of September 30, 2001

FY 2001 Budget Authority: $575,000,000

FY 2001 Outlays: $487,000,000

Current Status: Since 1993, HUD's HOPE VI Revitalization Grant program has awarded 165 grants to 98 cities, representing approximately $4.55 billion in development funds. According to HUD program data, this will result in demolition of about 78,000 distressed public housing units and development of a roughly equal number of new units. As of September 2001, about 47,000 units had been demolished and about 14,500 units had been developed.

Rental Assistance

Section 202 Supportive Housing for the Elderly

Enactment: Housing Act of 1959

Program Description: Direct federal grants and project-based Section 8 subsidies to nonprofit sponsors to finance rental or cooperative housing for the elderly.

Tenant Eligibility: Only households with heads 62 years or older and with very low incomes.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of adjusted monthly income.

Number of Existing Units: 65,000

FY 2001 Budget Authority: $779,000,000

FY 2001 Outlays: See Section 811 below.

Current Status: Approximately 6,500 units are funded annually in recent years.

Section 811 Supportive Housing for Persons with Disabilities

Enactment: Cranston-Gonzalez Affordable Housing Act of 1990

Program Description: Direct federal grants and project-based Section 8 subsidies to nonprofit sponsors to finance rental or cooperative housing for the disabled.

Tenant Eligibility: Available only for very low-income people with disabilities.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of adjusted monthly income.

Number of Existing Units: 18,000

FY 2001 Budget Authority: $217,000,000

FY 2001 Outlays: Section 202 and 811 had $774,000,000 in combined outlays.

Current Status: Approximately 1,650 units have been funded annually in recent years.

Section 221(d)(3) and Section 221(d)(4) Multifamily Rental Housing for Moderate-Income Families

Enactment: National Housing Act of 1961

Program Description: HUD insures mortgages made by private lenders to help finance construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income or displaced families. The principal difference between the two programs is that HUD may insure up to 100% of total project cost under Section 221(d)(3) for nonprofit and cooperative mortgagors, but only up to 90% under Section 221(d)(4), regardless of the type of mortgagor.

Applicant Eligibility: Section 221(d)(3) and 221(d)(4) mortgages may be obtained by public agencies; nonprofit, limited dividend, or cooperative organizations; private builders; or investors who sell completed projects to such organizations. Section 221(d)(4) mortgages may also be obtained by profit-motivated sponsors.

Tenant Eligibility: Tenant occupancy is not restricted by income limits. Projects may be designed specifically for the elderly or handicapped.

FY 2001 Program Level: $2,353,706,686 in mortgages insured

Current Status: In FY 2001, the department insured mortgages for 179 projects with 32,343 units.

Section 221(d)(3) Below Market Interest Rate (BMIR)

Enactment: National Housing Act of 1961

Program Description: Subsidized below-market interest rate mortgage insurance program providing rental housing for low-income families. Loans are made by private lenders at the reduced rate and then purchased at face value by the federal government.

Tenant Eligibility: New tenants generally could not have an income exceeding 95% of area median. The program was intended to serve those ineligible for public housing but unable to meet market rents.

Rent Structure: Tenants paid the established FHA rent or, if their incomes exceeded 110% of the area median, an amount equal to 120% of the FHA rent. In some of the projects, deeper subsidies were added to some units so that tenants would pay no more than 30% of their income.

Number of Existing Units: 144,978 (73,939 also have Section 8 funding)

Current Status: There have been no additional financial commitments for this program since 1968. Many BMIR projects ran into financial difficulties in the early 1970s. All projects suffered from the surge in operating costs after 1973 and many received assistance under the Section 8 Loan Management program.

Rent Supplement Program

Enactment: Housing and Urban Development Act of 1965

Program Description: The first direct rent supplement. This subsidy paid the difference between the economic rent (the rent necessary to cover debt service, operating costs and limited profit) and 25% of tenant income (now raised to 30%).

Tenant Eligibility: Rent supplement subsidies were converted to Section 8 subsidies by 1983. Section 8 eligibility rules now apply.

Rent Structure: Tenants paid between 25% and 30% of monthly adjusted income or 30% of the market rent, whichever was greater.

Number of Existing Units: 20,860

Current Status: No new commitments since 1973.

Section 236 Rental Program

Enactment: Housing and Urban Development Act of 1968

Program Description: Interest-rate subsidy to nonprofit or limited-dividend developers. The mortgage interest rate was subsidized down to 1% for loans made through private lenders and insured by FHA. Basic rents on the projects were calculated to cover the mortgage, operating costs, and a limited profit.

Tenant Eligibility: Incomes at or below 80% of the area median. In addition, tenants had to be able to pay a "basic rent" (the lowest rent made possible by the mortgage interest subsidy that supported the project's development), unless supplemented with some form of rental subsidy (e.g., Rental Assistance, Rent Supplement or Section 8 Loan Management Set Aside).

Rent Structure: Tenants paid the higher of basic rent or 30% of adjusted monthly income (up to an established ceiling). Rents in excess of basic rents were remitted to the government.

Number of Existing Units: 464,020 (403,697 also have Section 8 Loan Management funding)

Current Status: No new commitments since 1973.

Section 8 New Construction and Substantial Rehabilitation

Enactment: Housing and Community Development Act of 1974

Program Description: Subsidy to fill gap between tenant rent and contract rent for the unit. Subsidy commitment to owner for 20-40 years provides incentive for construction and for owner to reserve units for low-income tenants. Many projects were built with Section 202 direct loans for elderly housing.

Tenant Eligibility: Income below 80% of the area median, adjusted for family size. Forty percent of new admissions each year must have incomes below 30% of area median.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of monthly adjusted income in rent.

Number of Existing Units: 850,766 (including 207,131 built under the original Section 202 direct loan program)

Current Status: No new commitments since 1983.

Section 8 Moderate Rehabilitation

Enactment: 1978

Program Description: Rental subsidy administered by the housing authority and tied to rehabilitated units. Subsidy commitment to owner is 15 years.

Tenant Eligibility: Income lower than 50% of the area family median, adjusted for family size.

Rent Structure: Rents are limited to 125% of the local fair market rent (FMR) for comparable Section 8 Existing units.

Current Status: No new commitments since 1991.

Section 8 Certificate and Voucher (Existing Housing) Program

Enactment: Housing and Community Development Act of 1974 (certificates) and 1987 (vouchers). In 1998, the Quality Housing and Work Responsibility Act (QHWRA) merged the two programs into the housing choice voucher program.

Program Description: Vouchers that pay property owner the difference between 30% of the tenant's income and the lower of the unit rent or a payment standard. Any unit meeting program housing quality standards with a reasonable (i.e., market comparable) rent that leases for no more than the FMR is eligible. Recipients are chosen by local PHAs from Section 8 waiting lists. Recipients have the freedom and responsibility to find housing that meets program quality and rent standards. If recipients' existing housing unit meet standards and are available at a reasonable rent, they do not need to move.

Tenant Eligibility: Income must not exceed 50% of the area median adjusted for family size or, on an exception basis, 80% of the area median. At least 75% of families admitted to the voucher program must have extremely low incomes (not exceeding 30% of area median).

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of adjusted monthly income in rent. Tenants may choose to rent units for more or less than the payment standard. When initially leasing a unit where the gross rent exceeds the payment standard, a tenant may not pay more than 40% of adjusted monthly income.

Number of Existing Units: 1.8 million

FY 2001 Budget Authority: $11,970,000,000

FY 2001 Outlays: $16,720,000,000

Current Status: In recent years, an average of 38,000 vouchers have been added to the budget annually. In 2001, the voucher utilization rate (defined as the percentage of available vouchers under lease or the percentage of annual budget authority spent) was 93%. In 2002, the utilization rate is estimated at 95%. In comparison, the national voucher success rate (defined as the percentage of families provided vouchers who succeed in leasing units) was estimated to be 71% in 2000, down from 86% in 1993.

Section 8 Loan Management, Property Disposition and Conversions

Enactment: Housing and Community Development Act of 1974

Program Description: Section 8 Loan Management Set Aside program reduces claims on the department's insurance funds by aiding FHA-insured or Secretary-held projects with potentially serious financial difficulties. The Section 8 Property Disposition Program provides assistance with the sale of HUD-owned multifamily rental housing projects and the foreclosure of HUD-held mortgages on rental housing projects. The conversion of Rent Supplement and Rental Assistance Payments contracts to Section 8 Loan Management was completed over a decade ago. These converted units are now accounted for as Loan Management contracts and units.

Tenant Eligibility: Income below 80% of the area median adjusted for family size. Forty percent of new admissions each year must have incomes below 30% of area median.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of adjusted monthly income. Section 8 subsidizes the difference between the tenant rent and the basic rent (Section 236 mortgages) or the tenant rent and the economic rent (Section 221 BMIR mortgages).

Number of Existing Units: Approximately 5,200 Loan Management contracts cover 388,000 units. Approximately 650 Property Disposition contracts cover 59,000 units.

FY 2001 Outlays: Annual outlays for these units amount to approximately $1.5 billion for the Loan Management Program and $330 million for the Property Disposition Program.

Current Status: The department has not provided new funding for several years. At present, the only activity associated with these programs is the renewal of previous contracts.] The FY 2003 budget request to renew expiring Loan Management units amounts to $1.5 billion for an expected 331,879 units. The Property Disposition renewal request for the 34,066 units is $232 million.

Mark to Market

Enacted: Multifamily Assisted Housing Reform and Affordability Act of 1997

Program Description: Preserves low-income rental housing affordability while reducing the long-term costs of federal rental assistance, including project-based assistance, and minimizing the adverse effect on FHA insurance funds. This includes (1) reducing project rents to no more than comparable market rents, (2) restructuring the HUD-insured or HUD-held financing so that monthly payments on the first mortgage can be paid from the reduced rent levels, (3) performing any needed rehabilitation of the project, and (4) ensuring competent management.

Tenant Eligibility: Income below 80% of area median, adjusted for family size. Forty percent of new admissions each year must have incomes below 30% of area median.

Project Eligibility: The project must have one or more FHA-insured mortgages, one or more project-based Section 8 or other approved housing assistance contracts expiring on or after October 1998, and assisted rents must exceed comparable market rents.

Rent Structure: Tenants pay the greater of 10% of monthly income or 30% of monthly adjusted income.

FY 2001 Obligation: $293,000,000 for loan restructures

FY 2001 Program Level: As of May 2001, $53,900,000 in payments from the FHA fund had been made since the Office of Multifamily Housing Assistance Restructuring (OMHAR) came into existence. The Mark-to-Market program is expected to result in Section 8 program savings of $218 million in FY 2002.

Number of Existing Units: About half of the HUD-insured Section 8 portfolio is estimated to have above-market rents and eventually enter the mark-to-market program. OMHAR estimated that about 62% of those would receive full mortgage restructuring and the remaining 38% would receive rent restructuring only.

Current Status: As of June 15, 2001, OMHAR had contracts with 33 administrative entities and the number of properties in the program was 1,558. OMHAR had completed restructurings for 138 of the properties requiring full mortgage restructurings and 500 of those requiring only rent reductions. OMHAR estimates that the restructurings will result in about $563,000,000 in federal savings over a 20-year period. In January 2002, President Bush signed legislation extending the program for another five years.

Section 515 Rural Rent Housing Direct Loans

Enactment: Housing Act of 1949

Program Description: Direct loans made to developers at 1% interest rate through the Rural Housing Service (RHS) of the U.S. Department of Agriculture. Payments are made directly from the federal government to the developer.

Tenant Eligibility: Tenants must have incomes at or below 80% of area median. Households with incomes below 50% of median may receive additional assistance through the HUD Section 8 program or the FmHA Section 521 program.

Rent Structure: Tenants may obtain rental assistance through the Section 521 program, which provides funds directly to developers so that tenants pay no more than 30% of adjusted income for rent and utilities. The developer receives enough rent to cover mortgage costs, with any excess going back to the government to offset the reduced interest rate.

Number of Existing Loans: 484,672 (including 45,000 Section 8 units)

FY 2001 Authorized Level: $114,000,000 (direct loan level supportable by subsidy budget authority)

FY 2001 Program Level: In FY 2001, $1,212,000,000 new disbursements were made for all RHS direct loan programs, including the Section 515 program.

Current Status: Through 2000, 523,609 loans had been made through the Section 515 direct loan program.

Homeownership Assistance

Section 235 Low-Income Homeownership Program

Enactment: Housing Act of 1968

Program Description: Interest rate subsidy to low- and moderate-income homeowners. In its initial form, the interest rate could be reduced as low as 1% to limit mortgage payments to 20% of income. Subsidy is attached to the unit, not the family, and is non-transferable.

Homebuyer Eligibility: Homebuyers must have incomes at or below 95% of area median.

Number of Existing Units: 31,176

Current Status: No funding since 1974.

Section 502 Rural Homeownership Program, Direct Loan Program

Enactment: Housing Act of 1949

Program Description: Direct loans from the Rural Housing Service of the U.S. Department of Agriculture to rural homeowners to assist in the purchase, rehabilitation, or improvement of housing units. Section 502 direct loans may also be used to refinance debts when necessary to avoid losing a home or when necessary to make rehabilitation of a house affordable.

Homebuyer Eligibility: Homebuyers must have incomes at or below 80% of area median. At least 40% of appropriated funds are reserved for households with incomes at or below 50% of area median; the remaining funds may be used for households with incomes between 50% and 80% of area median.

FY 2001 Loans Outstanding: 547,622

FY 2001 Authorized Level: $1,065,000,000 (direct loan level supportable by subsidy budget authority)

FY 2001 Program Level: In FY 2001, $1,212,000,000 new direct loan disbursements were made for all RHS direct loan programs, including but not limited to the Section 502 direct loan program.

Current Status: The FY 2002 obligation for the program is estimated at $1,076,998,750. Approximately 15,000 new direct loans have been made annually in recent years.

Community Development

Urban Renewal

Enactment: Housing Act of 1954

Program Description: Funding for the acquisition, clearance and development of large parcels of urban land to achieve large-scale redevelopment of blighted communities. Displaced households had to be relocated to other affordable units. The program's primary focus was not housing development.

Eligibility: Open space or rundown or deteriorated residential areas.

Number of Existing Units: During the program's duration, approximately 400,000 units were demolished and 10,760 units were constructed.

Current Status: No funding since 1974.

Model Cities

Enactment: Housing and Urban Development Act of 1966

Program Description: Demonstration program to help 150 cities improve living conditions. Cities were chosen for participation with the consent of the elected leadership. Participating cities were allowed to plan and develop, with citizen participation, individual programs according to their particular needs.

Eligibility: Communities chosen on a competitive basis to receive grants based on needs.

Number of Existing Units: Unknown.

Current Status: The program was funded for a total of $2.3 billion, to be used over a six-year period. No new funding since 1974.

Community Development Block Grants (CDBG)

Enactment: Housing and Community Development Act of 1974

Program Description: Block grants to localities to fund neighborhood redevelopment, economic development, and community services. Eligible uses include acquisition, rehabilitation or demolition of real estate and public facility provision.

Applicant Eligibility: Any central city of an MSA, any local government of over 50,000 people (842 jurisdictions), urban counties with at least 200,000 people (147 counties) automatically qualify for formula-based funds. All other jurisdictions receive their funds through the state.

Recipient Eligibility: At least 70% of all funds must be used for people with low or moderate incomes. The national average share used for these groups is 90%.

FY 2001 Budget Authority: $5,112,000,000

FY 2001 Outlays: $4,939,000,000

Current Status: The CDBG program receives widespread political support for providing local flexibility in community development. Since its inception, approximately 28% of CDBG funds have gone to housing. In FY 2001, housing's share was 35%.

HOME Investment Partnerships

Enactment: National Affordable Housing Act of 1990

Program Description: Block grants to localities to expand the supply of affordable housing. Uses include acquisition, rehabilitation, and new construction of rental units; development of homeownership units; direct assistance to homebuyers; and tenant-based rental assistance.

Applicant Eligibility: States, cities, urban counties, and consortia (of contiguous units of general local governments with a binding agreement) are eligible to receive formula allocations.

Beneficiary Eligibility: The maximum income for tenants in HOME-assisted rental housing units are set at 80% of area median adjusted for family size. However, 90% of families receiving rental assistance from a fiscal year's allocation must have incomes of no more than 60% of area median family income. In projects with five or more HOME units, at least

20% of the units must be affordable to households earning 50% of the area median income. Assisted homeowners and homebuyers must earn less than 80% of the area median income.

Number of Existing Units: 627,000 units created, rehabilitated or purchased with funds committed; 72,000 families have received tenant-based rental assistance.

FY 2001 Budget Authority: $1,796,000,000

FY 2001 Outlays: $1,424,000,000

Current Status: Funding for the program continues. Households with incomes below 30% of area median occupy 45% of HOME rental housing; 97% of recipients have less than 50% of area median income. Recent annual production has been 55,000-85,000 units annually.

Empowerment Zones and Enterprise Communities

Enactment: Omnibus Budget Reconciliation Act of 1993

Program Description: Project grants and tax relief to distressed neighborhoods to encourage economic revitalization and job creation, as well as move residents towards self-sufficiency. Recipients of Empowerment Zone designation receive $10 million per year for 10 years as well as access to $2.2 billion in tax-exempt bond authority, Enterprise Communities alternatively receive a smaller grant of $3 million per year.

Recipient Eligibility (urban areas only): Areas of pervasive poverty and unemployment and general distress; maximum population of 200,000 or 20 square miles or less in area; a continuous boundary, or consists of not more than six noncontiguous parcels, with the total noncontiguous are no more than 2,000 acres; located entirely within the jurisdiction of the application group; 90% of census tracts in the zone must have a poverty rate of at least 25% and none may have less than 20%; may not include any part of the CBD unless the poverty rate in all parts of the district exceeds 35%. Note: Rural area criteria are set by the Department of Agriculture.

Beneficiary Eligibility: Residents and businesses in designated urban areas.

FY 2001 Budget Authority: $185,000,000

FY 2001 Outlays: $31,000,000

Current Status: Education and job training have been provided to 42,000 residents of zones, and 30,000 people have received help finding employment. In the first round of funding in 1994, 8 urban Employment Zones (EZs) and 65 Enterprise Communities (ECs), and 33 rural EZ / ECs were designated. In 1999, a second round of funding established another 15 urban EZs.

Special Populations

Homeless Assistance Grants

Enactment: McKinney Act of 1987

Program Description: Funds provided for emergency shelter, supportive housing, Section 8 Moderate Rehabilitation for single-room occupancy developments, and the Shelter Plus Care program, all of which provide both housing and services for the homeless. Grants are disbursed to local groups that belong to continuums of care through a combination of formula and competitive NOFA programs.

Applicant Eligibility: States, local governments (as well as local consortia), nonprofits and PHAs are all eligible. Funds can be used for acquisition, rehabilitation, new construction, operations, assistance, and services.

Number of Existing Units: FY 2001 funding will be used to support or create 70,000 beds (emergency, transitional and permanent) for the homeless. FY 2001 funding will serve 229,000 people at any one time, with 683,000 people served over the terms of the contracts.

FY 2001 Budget Authority: $1,023,000,000

FY 2001 Outlays: $965,000,000

Current Status: In 2001, 3,275 communities applied for funds totaling $1.33 billion; 78% of the community program proposals were approved.

Native American Housing Assistance and Self-Determination Act

Enactment: Native American Housing Assistance and Self-Determination Act of 1996

Program Description: Block grant assistance to Indian tribes to permit affordable housing- related activities including development, assistance, services, housing management, and safety.

Eligibility: Low-income families living within Indian tribal jurisdictions.

FY 2001 Budget Authority: $650,000,000

FY 2001 Outlays: $684,000,000

Number of Existing Units: Since 1997, 25,000 units have been rehabilitated or developed using block grant funds.

Current Status: Tribes use the block grants for a variety of housing and housing-related services. Funding has consistently been less than necessary to meet needs.

Housing for Persons with AIDS (HOPWA)

Enactment: AIDS Housing Opportunity Act, as amended by the Housing and Community Development Act of 1992

Program Description: Resources and incentives for states and localities to devise long-term comprehensive strategies for meeting the housing needs of persons with AIDS or related diseases and their families.

Applicant Eligibility: Entitlement grants are awarded by formula to states and qualifying cities for eligible metropolitan statistical areas (EMSAs) with the largest number of cases of AIDS. The most populous city serves as the applicant / grantee for the award. Competitive grants are also awarded to (a) states, local governments and nonprofit organizations for special projects of national significance, and (b) projects submitted by states and localities in areas that do not qualify for HOPWA formula allocations. Nonprofit organizations can apply for projects of national significance and may also serve as a project sponsor for other types of grants.

Beneficiary Eligibility: Beneficiaries are low-income persons with HIV or AIDS and their families. Regardless of income, persons with AIDS may receive housing information. Persons living near community residences may receive educational information.

Rent Structure: When the grant is used for rental housing, rents cannot exceed 30% of tenant incomes.

Number of Existing Units: HOPWA funds have been used for either operating costs or capital development of approximately 8,000 units.

FY 2001 Budget Authority: $258,000,000

FY 2001 Outlays: $241,000,000

Current Status: In FY 1999, HOPWA provided housing assistance to 51,875 people; 68% of the funds went to housing assistance.

Mortgage Insurance and Loan Guarantees

FHA-Single Family

Enactment: National Housing Act of 1934

Program Description: Mortgage insurance provided through private lenders to enhance the credit of homebuyers and help them qualify for mortgages. The Section 203(b) program is currently the primary FHA single-family mortgage insurance program and provides mortgage insurance without a subsidy.

Eligibility: There are no income limits for this program. Insurance premiums vary based on the applicant's loan-to-value (LTV) ratio.

Number of Loans Outstanding: 810,995 at the end of 2000

FY 2001 Authorized Level: $160,000,000,000 (guaranteed loan level supportable by subsidy budget authority)

FY 2001 Program Level: $107,449,000,000 in insurance written

Current Status: Since 1934, FHA and HUD have insured the mortgages on 30 million homes.

FHA-Multifamily

Enactment: National Housing Act of 1934

Program Description: Mortgage insurance provided for credit enhancement of privately developed multifamily properties. The primary programs are the Section 221(d)(4) and Section 221(d)(3) programs for the construction and substantial rehabilitation of multifamily rental or cooperative housing, and the Section 223(f) program for the purchase and refinance of existing multifamily rental properties.

Tenant Eligibility: There are no specific tenant requirements for FHA multifamily loans.

Number of Existing Units: An estimated 1.4 million units are in developments with active insurance contracts.

FY 2001 Authorized Level: $10,685,000,000 (guaranteed loan level supportable by subsidy budget authority)

FY 2001 Program Level: $4,195,000,000 of insurance written

Current Status: Since 1934, FHA has insured 38,000 multifamily properties with 4.1 million apartments.

VA Loan Guarantees

Enactment: Serviceman's Readjustment Act of 1944

Program Description: Encourages private lenders to make mortgages to veterans by guaranteeing payment on a portion of the loan in the case of default.

Eligibility: A varying amount of duty served depending on the type and timing of service.

Number of Outstanding Loans: 3,090,338 in FY 2000

FY 2001 Authorized Level: $31,948,000,000 (guaranteed loan level supportable by subsidy budget authority)

FY 2001 Program Level: $31,138,000,000 of new guaranteed loans disbursed

Current Status: From its beginning through 1996, VA guaranteed 15.3 million loans.

Section 502 Guaranteed Rural Housing Loan Program

Enactment: Housing Act of 1949

Program Description: Variant of the Section 502 Direct Loan program (described above), designed to assist low- and moderate-income rural households in purchasing homes. In this case, the Rural Housing Service does not make a loan directly to an eligible borrower, but instead guarantees a loan made by a commercial lender.

Homebuyer Eligibility: Homebuyers must have incomes at or below 115% of the area median and be unable to qualify for conventional mortgage credit.

Number of Existing Units: 215,708 as of April 2001

FY 2001 Authorized Level: $3,136,000,000 (guaranteed loan level supportable by subsidy budget authority)

FY 2001 Program Level: In FY 2001, $2,171,000,000 in new loan disbursements were made for the Section 502 and Section 538 loan guarantee programs combined.

Current Status: The FY 2002 obligation is estimated at $3,137,968,750.

Section 538 Rural Rental Housing Guarantee Program

Enactment: Housing Act of 1949

Program Description: Guarantees up to 90% of the total loan amount for development of rural rental housing. Applicants must be approved by Fannie Mae, Freddie Mac, HUD or a state HFA. The guarantees are awarded by NOFA applications on a monthly basis. In FY 2000, an earlier demonstration program became the Section 538 Guaranteed Rural Rental Housing Loan.

Tenant Eligibility: Very low- or moderate-income families. Elderly or disabled persons are permitted with incomes up to 115% of area median income.

Number of Existing Units: 672 units as of January 2002

FY 2001 Authorized Level: $100,000,000 (guaranteed loan level supportable by subsidy budget authority)

FY 2001 Program Level: In FY 2001, $2,171,000,000 in new loan disbursements were made for the Section 502 and Section 538 programs combined.

Current Status: In 2000, the Section 538 program guaranteed 2,895 units.

Tax and Bond Programs

Private Activity Bonds

Enactment: Private activity bonds were referred to as Industrial Development Bonds before the Tax Reform Act of 1986.

Program Description: Tax-exempt bond issuances from the state that have a public benefit but can be used by private individuals. A per capita allocation is provided to each state, with a "small state minimum" of $225 million. Uses include single-family and multifamily housing, manufacturing facilities, student loans, transportation, municipal services, among others.

FY 2002 Authorized Level: $24,216,606,217

FY 2001 Program Level: $3,750,000,000 (outlay equivalent of tax expenditures)

Current Status: Per capita allocation was put in place in 1986 and set at $50. This amount was raised in 2001 and will now increase with inflation.

Mortgage Revenue Bonds

Enactment: Single-family bonds were authorized by the Tax Code of 1954 and generally followed Industrial Development Bond rules until enactment of the Mortgage Subsidy Bond Tax Act of 1980. This act created "mortgage subsidy bonds" and restricted their issuance through various requirements, including purchase price limits.

Program Description: Low interest-rate bonds issued as part of the private activity bond authority are used to provide below-market interest rate mortgages to first-time homebuyers to lower the costs of homeownership.

Homebuyer Eligibility: First-time homebuyers with up to median income (either state or area). The cost of the home cannot exceed 90% of the area average purchase price. In disadvantaged areas, income and price limits can be higher.

2000 Program Level: $10,767,892,177 (total 2000 issuance); $1,150,000,000 (outlay equivalent)

Current Status: Through 2000, 2,177,873 loans had been made through the MRB program. Most loans are used to assist homebuyers with incomes below the program limits.

Tax-Exempt Multifamily Bonds

Enactment: Tax-exempt multifamily bonds were authorized under the Tax Code of 1954 as Industrial Development Bonds. The 1986 Tax Reform Act prohibited issuance of industrial development bonds except for certain purposes, such as creation of rental housing.

Program Description: Authority for state HFAs to issue bonds (private activity, taxable, nonprofit or government purpose) for multifamily housing. Bonds for nonprofits are uncapped; issuances for all other groups have limits.

Project Eligibility: Developers have two ways to meet affordability requirements—20% of the units in the development must be available to tenants with less than 50% of area median income, or 40% of the units must be occupied by tenants with incomes of less than 60% of area median.

Rent Structure: Rents must be held at a reasonably affordable level "consistent with other federal programs." This is generally interpreted as no more than 30% of the selected income thresholds.

Number of Existing Units: 766,392 as of the end of 2000

2000 Program Level: $1,668,713,563 (total new issuances); $280,000,000 (outlay equivalent)

Current Status: This program financed 52,000 units in 2000. Three-quarters of these units were affordable to families with 60% or less of area median income.

Low Income Housing Tax Credit

Enactment: Tax Reform Act of 1986

Program Description: A ten-year tax credit as an incentive to private developers to acquire, build or rehabilitate low-income rental units. Developers enter into a minimum 30-year, extended low-income use agreement. Four percent tax credits are uncapped and can be used in combination with tax-exempt multifamily bonds. Nine percent tax credits are authorized based on a per capita allocation by state; they are administered by state HFAs and can be used in conjunction with certain additional subsidies. Developers also have access to a national pool of unused tax credits

Project Eligibility: Developers have two ways to meet affordability requirements—20% of the units in the development must be available to tenants with less than 50% of area median income, or 40% of the units must be occupied by tenants with incomes of less than 60% of area median.

Rent Structure: Gross rents on designated units may not exceed 30% of the "imputed income limitation," which is the maximum income a family within the rent restrictions could have.

Number of Existing Units: 1,122,240 units received allocations (of 9% credits) between 1987 and 2000.

FY 2002 Authorized Level: $513,800,832 in per capita credits

FY 2001 Program Level: $4,360,000,000 (outlay equivalent)

Current Status: Tax credits serve an even lower-income population than is required and produce 60,000-100,000 units per year. Per capita allocations have recently been raised and starting in 2003, both the per capita allocation and small state minimum will be adjusted for inflation.

Fair Housing

Fair Housing Initiatives Program (FHIP)

Enactment: Civil Rights Act of 1968

Program Description: Funds fair housing enforcement efforts. The program concentrates on areas where significant discrimination has occurred or where there is a lack of local fair housing assistance or enforcement services. Funds can be used for starting new organizations aiding grantees to use good methods to investigate or resolve fair housing complaints.

Applicant Eligibility: Eligible entities include state and local government, public or private nonprofit organizations or institutions, and other public or private entities formulating or carrying out programs to prevent or eliminate discriminatory housing practices.

Beneficiary Eligibility: Any person or group of persons aggrieved by a discriminatory housing practice because of race, color, religion, gender, disability, familial status, or national origin.

FY 2001 Budget Authority: $24,000,000

FY 2001 Outlays: See FHAP below

Current Status: In FY 2000, FHIP made 26 awards totaling about $5.5 million. One of the projects was national in scope while the rest were regional, local or community-based. Six grants emphasized disability rights or homeownership.

Fair Housing Assistance Program (FHAP)

Enactment: Civil Rights Act of 1968

Program Description: Funds to promote coordination of federal, state, and local efforts to enforce and uphold fair housing laws. Funding is provided through a formula grant for enforcement and training activities.

Applicant Eligibility: State and local fair housing enforcement agencies administering state and local fair housing laws and ordinances that have been certified by HUD. The agencies must be dedicated to upholding the Fair Housing Act and have executed formal written agreements with HUD to process housing discrimination complaints.

Beneficiary Eligibility: Any person or group of persons aggrieved by a discriminatory housing practice because of race, color, religion, gender, disability, familial status, or national origin.

FY 2001 Budget Authority: $22,000,000

FY 2001 Outlays: FHIP and FHAP together had outlays of $39,000,000

Current Status: Since passage of the strengthened Fair Housing Act in 1989, 89 jurisdictions have amended their fair housing laws to make them substantially equivalent to the Act. In 2000, 88 jurisdictions received financial assistance under this program.

Federal Income Tax Treatment

Rental Housing Deductions

Distinction Between Cash Flow and Taxable Income: Depreciation and amortization are deductible expenses for federal income tax purposes; deposits to the reserve for replacements and mortgage principal payments are not. A substantial fraction of rental property cash flow is therefore sheltered from taxes, at least in the early years when depreciation and amortization deductions are high and when reserve deposits and principal payments are low.

Refinancing: Excess proceeds are not subject to income taxation but, instead, create a deferred income tax liability payable when the property is sold.

Basis: The rental property owner's basis is the original acquisition cost, plus additional capital investments made over time, minus depreciation deductions. Any amount that exceeds this is taxed at the capital gains rate.

"Step up on Death": Under current tax law, if an owner dies, his or her estate receives the rental property at its fair market value and no capital gain is recognized. This creates a powerful incentive for owners of rental property to hold properties until death.

Depreciation: Under current tax law, investments in buildings can be depreciated on a straight-line basis over a standard 27.5-year useful life. Investments in fixtures and site improvements can be depreciated over shorter useful lives.

Passive losses: Prior to 1986, owners whose rental properties generated tax losses could offset those losses against other taxable income. In 1986, however, Congress provided that passive losses could be offset only against passive income and not against other types of income. This restriction does not apply to active investors (generally, real estate professionals who directly manage their real estate investments).

Homeowner Deductions

Mortgage interest: Homeowners who itemize on their tax returns can deduct the interest paid pay on their mortgages.

Capital gains on sales: Only gains on home sales that exceed $250,000 per individual are taxable.

State and local property taxes: Homeowners may deduct the value of state and local property taxes paid on their homes.

Information verified by Abt, Associates, Inc.

Sources: Catalog of Federal Domestic Programs website (http://www.cfda.gov/); Code of Federal Regulations; HUD website (http://www.hud.gov/); HUD Office of the Deputy Assistant Secretary for Public and Assisted Housing Delivery, Real Estate and Housing Performance Division; National Council of State Housing Agencies; Congressional

Legislation website (http://thomas.loc.gov); U.S. General Accounting Office, *Multifamily Housing: Issues Related to Mark-to-Market Program Reauthorization*, Report #GAO-01-800, July 11, 2001; Barry G. Jacobs, *HDR: Handbook of Housing and Development Law: 1999* (New York: West Group, 1998); National Association of Home Builders. *Low and Moderate Income Housing: Progress, Problems and Prospects* (Washington, D.C.: 1986).

Appendix 4 | *Acronyms Used in Report*

ACC	Annual Contributions Contract
AIDS	Acquired Immune Deficiency Syndrome
AMI	area median income
AMT	alternative minimum tax
BMIR	below-market interest rate
CBD	central business district
CBO	Congressional Budget Office
CDBG	Community Development Block Grant
CDC	community development corporation
CDFI	Community Development Financial Institution
CRA	Community Reinvestment Act
DOI	U.S. Department of the Interior
DOL	U.S. Department of Labor
DOT	U.S. Department of Transportation
EITC	earned income tax credit
ELI	extremely low income
EMSA	eligible metropolitan statistical area
EZ/EC	Empowerment Zone / Enterprise Community
FASIT	Financial Asset Securitization Investment Trust
FHA	Federal Housing Administration
FHAP	Fair Housing Assistance Program
FHIP	Fair Housing Initiatives Program
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation (Freddie Mac)
FmHA	Farmers Home Administration
FMR	Fair Market Rent
FNMA	Federal National Mortgage Association (Fannie Mae)
FSS	Family Self-Sufficiency program
GAO	General Accounting Office
GCCA	Government Corporation Control Act
GDP	Gross Domestic Product
GI/SRI	General Insurance and Special Risk Insurance fund
GNMA	Government National Mortgage Association (Ginnie Mae)

GSE	government-sponsored enterprise
HAP	Housing Assistance Payment
HDR	*Housing and Development Reporter*
HFA	housing finance agency
HHS	U.S. Department of Health and Human Services
HI	high income
HIV	human immunodeficiency virus
HOME	Home Investment Partnerships Program
HOPWA	Housing Opportunities for Persons with AIDS
HQS	Housing Quality Standards
HUD	U.S. Department of Housing and Urban Development
IBC	International Building Code
IHDA	Individual Homeownership Development Account
IRA	Individual Retirement Account
IRC	Internal Revenue Code
LI	low income
LIHTC	Low Income Housing Tax Credit
LTV	loan to value
MAP	Multifamily Accelerated Processing
MFIP	Minnesota Family Investment Program
MI	moderate income
MRB	Mortgage Revenue Bond
MSA	metropolitan statistical area
MTO	Moving to Opportunity program
NAHASDA	Native American Housing Assistance and Self Determination Act
NCDI	National Community Development Initiative
NOFA	Notice of Funding Availability
OFHEO	Office of Federal Housing Enterprise Oversight
OMB	Office of Management and Budget
OMHAR	Office of Multifamily Housing Assistance Restructuring
PHA	public housing authority or agency
PHAS	Public Housing Assessment System
PHMAP	Public Housing Management Assessment Program
PTI	preservation tax incentive
QAP	Qualified Allocation Plan
QHWRA	Quality Housing and Work Responsibility Act of 1998
RAP	Rental Assistance Payment

REMIC	Real Estate Mortgage Investment Conduit
RESPA	Real Estate Settlement Procedures Act
RHS	Rural Housing Service
TANF	Temporary Assistance to Needy Families
TILA	Truth in Lending Act
VA	Veterans Administration
VLI	very low income
WIA	Workforce Investment Act

Appendix 5 | *Materials Available on CD-ROM & MHC Website*

In addition to its report, the Millennial Housing Commission makes available a number of items on its CD-ROM and website (www.mhc.gov).

CD-ROM

- Description of methods by which the Commission sought public input.
- List of Commission-sponsored meetings and hearings, including names of participants.
- Text of letter the Commission distributed seeking input on key issues, as well as a list of the people and organizations to which it was sent.
- Hearing testimony and statements submitted during other Commission-sponsored meetings.

Website

- Letter from MHC Co-Chairs Susan Molinari and Richard Ravitch.
- The Commission's legislative mandate and mission statement.
- Commissioner bios.
- Commission task forces.
- List of MHC hearings and links to testimony.
- Consultant products.
- List of focus meetings and links to statements.
- Responses to MHC solicitation letter, including summaries of responses on a variety of topics.
- PowerPoint presentation entitled "Federal Housing Assistance."

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