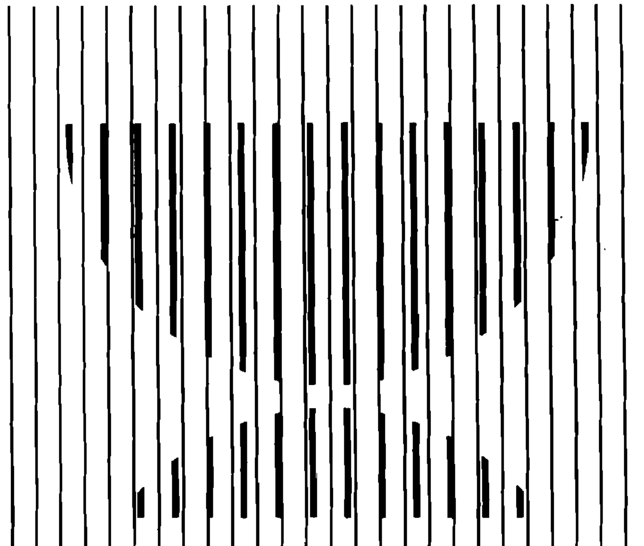
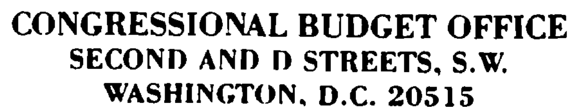
IMPLICATIONS OF THE PREPAYMENT PROVISIONS IN THE CRANSTON-GONZALEZ HOUSING ACT

April 1992





This staff memorandum examines the implications of the Low-Income Housing Preservation and Resident Homeownership Act of 1990, enacted as part of the Cranston-Gonzalez National Affordable Housing Act. The objective of that legislation is to preserve the low-income use of certain federally assisted rental housing projects. This memorandum illustrates the effects on tenants and on federal costs of preserving a typical project under the provisions of the statute, compares these costs with those of other types of housing aid, and discusses alternative ways of funding these provisions. In accordance with the Congressional Budget Office's (CBO's) mandate to provide objective and impartial analysis, the memorandum contains no recommendations.

Carla Pedone of the Human Resources and Community Development Division prepared the memorandum under the direction of Nancy Gordon and Bruce Vavrichek. The author gratefully acknowledges the contributions of Eric Guille, Kimberly Guise, Murray Ross, and Brent Shipp of CBO, and of Robert Gray and Arthur Reiger of the Department of Housing and Urban Development. Sherry Snyder edited the manuscript and Chris Spoor provided editorial assistance. Sharon Corbin-Jallow prepared the manuscript. Questions about the analysis may be addressed to Carla Pedone at (202) 226-2665.

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SUMMARY

During the late 1960s and early 1970s, several thousand low-income housing projects were developed by private owners under Sections 236 and 221(d)(3) of the National Housing Act. In exchange for various federal subsidies, restrictions were imposed on the projects in the form of rent controls and limitations on the income of families eligible to move into the units. Most for-profit owners of these projects were allowed the option of prepaying their federally subsidized mortgages after 20 years, thereby terminating these restrictions.

Over the next 15 years, owners of about 360,000 rental units will become eligible to prepay their mortgages and leave the programs. Concerned about the potential loss of these units from the inventory of assisted housing, the Congress enacted in 1990 the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) to ensure that most of these units remain available and affordable to low-income families and that current owners are fairly compensated.

If the provisions of LIHPRHA are fully funded, federal housing subsidies will increase substantially for families living in many of these projects, some of whom are considerably better-off than currently unassisted families. Total federal housing appropriations are unlikely to increase much over the next few years, however, because of severe constraints imposed by the Budget Enforcement Act. Thus, a trade-off exists between preserving all of the housing units eligible for prepayment and assisting a potentially larger group of low-income families with a cheaper form

of aid (such as housing vouchers) by allowing the owners of some projects--those that would be most expensive to retain as low-income housing--to prepay their mortgages.

LIHPRHA Provisions and Their Impact

Under the LIHPRHA provisions, current owners of prepayment-eligible projects generally may either retain their projects for low-income rental use or sell them to buyers who agree to do so. To encourage current or new owners to invest in these projects, LIHPRHA offers them incentives in the form of higher rents. Part of the increase in rents would come from higher payments by some tenants and part from increased federal subsidies such as those provided under Section 8 of the United States Housing Act of 1937. Rents received by owners or buyers may be raised as high as the cost limits permitted in the statute--typically 120 percent of the local fair market rent (FMR). The FMR is the maximum rent allowed under the Section 8 existing-housing rental certificate program. To keep the units affordable for tenants, federal subsidies would be provided to cover the difference between these higher rents and 30 percent of the tenants' income.

Under the statute, the low-income use of a project can generally be terminated only if federal funds are not available to provide these incentives or if the current owner wishes to sell the project but no buyer can be found who will

maintain its low-income use. In those cases, displaced tenants who are eligible for federal aid will receive housing vouchers to help pay their rent elsewhere.

This memorandum illustrates the impacts on tenants' rent payments and federal subsidies of preserving a typical Section 236 project. Under the statute, average rent payments by very-low-income tenants who did not previously receive Section 8 aid would be reduced by 52 percent, and average rent payments by certain higher-income tenants would rise by 15 percent. Although in some projects rent increases may be much greater than 15 percent for higher-income tenants, no tenant would be required to pay more than 30 percent of income for rent.

Average federal subsidies per family would rise substantially, with the size of the increase depending on the new rent levels and on whether the tenants previously received Section 8 aid. For example, for a project with a new rent at the federal cost limit, average annual subsidies for very-low-income families would increase to more than $6,200 per family. This amount represents an increase of more than 90 percent for families who already receive Section 8 aid and almost 600 percent for those who would start receiving it under the prepayment provisions.

In terms of federal outlays, preserving a typical Section 236 project would be less expensive than providing vouchers only if the new rent under the LIHPRHA provisions is less than about 85 percent of the local FMR. Preliminary estimates by the Department of Housing and Urban Development (HUD) predict such low rents in less than half the projects, but that assessment may change once more complete

information becomes available. In all other cases, issuing vouchers to low-income families would be cheaper than providing the incentives to keep the projects as low-income housing. Issuing vouchers would not necessarily place all current tenants in subsidized units, however, because some tenants with lower income might not be able to find suitable new units for which they could use their vouchers. Moreover, current tenants in these projects who have the highest income would not benefit from the vouchers.

Policy Alternatives

If the prepayment provisions were fully funded, as directed by the Congress in enacting LIHPRHA, dwellings constructed with federal subsidies to serve low-income families would be preserved to the fullest extent possible, and involuntary displacement of current tenants would be minimized. Nevertheless, fewer families would be assisted than if some expenditures were redirected to vouchers. Moreover, some families benefiting from the potentially large subsidies inherent in the preservation incentives would have higher income than many eligible families who do not receive federal aid.

Alternatively, preservation incentives could be funded only for those projects whose preservation costs are relatively low. Owners of the most expensive projects would be allowed to prepay their mortgages, and the displaced tenants who are eligible for federal aid would receive vouchers. The savings from such a scheme

could be used to issue additional vouchers for currently unassisted families or for other purposes. In this way, the number of assisted families could expand without also increasing outlays. Moreover, the treatment of families receiving aid under various housing assistance programs would be less uneven than if all the projects were retained for low-income use, because the government would not be subsidizing the much higher rents necessary to retain the most expensive projects. If some mortgages were prepaid, however, some of the displaced families could face problems finding new housing even with their vouchers. This outcome would be particularly likely in areas with low vacancy rates in units renting at or below the FMR. As a result, some of the currently assisted families would have to pay more than 30 percent of their income for rent.

INTRODUCTION

During the late 1960s and early 1970s, several thousand low-income housing projects containing roughly 600,000 units were developed by private owners under Sections 236 and 221(d)(3) of the National Housing Act. In exchange for various subsidies provided to the owners of these projects, the use of these units was restricted through rent controls and limitations on the income level of families eligible to move into the units. In general, nonprofit owners were locked into these use restrictions for the 40-year life of their mortgages, but most for-profit owners were allowed the option of prepaying their mortgages after 20 years, thereby terminating the restrictions.[1]

Owners of about 360,000 of these units already are or will become eligible to prepay their mortgages through 2007 (see Table 1). This possibility has raised concern about the potential loss of a viable means of providing low-income housing. The concern culminated in the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA), enacted as part of the Cranston-Gonzalez National Affordable Housing Act.[2] A basic objective of LIHPRHA is to ensure that most of these units remain available and affordable for low-income families and that current owners are fairly compensated.

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1. For a more detailed discussion of the programs involved in the prepayment issue, see Congressional Budget Office, "The Potential Loss of Assisted Housing Units as Certain Mortgage-Interest Subsidy Programs Mature" (March 1987).

2. Temporary measures for dealing with the prepayment problem were enacted in the Emergency Low Income Housing Preservation Act of 1987. This statute allowed prepayment only under very restrictive conditions, effectively putting a moratorium on prepayment for the approximately 58,000 units whose owners became eligible to prepay before 1991.

TABLE 1. ESTIMATED NUMBER OF PROJECTS AND UNITS ELIGIBLE FOR PREPAYMENT

Fiscal Year	Number of Projects	Number of Units
Before 1992	803	99,223
1992	452	46,414
1993	509	50,109
1994	664	69,779
1995	378	42,801
1996	141	16,258
After 1996	240	32,252
Total	3,187	356,836

SOURCE: Congressional Budget Office using data provided by the Department of Housing and Urban Development.

NOTE: Of the roughly 99,000 units that became eligible for prepayment before 1992, about 6,600 have received incentives under the Emergency Low Income Housing Preservation Act of 1987. No incentives have been provided under the Low-Income Housing Preservation and Resident Homeownership Act because of delays in publishing the regulations.

Under LIHPRHA's so-called prepayment provisions, owners of projects eligible to prepay their mortgages will be offered financial incentives to preserve those projects for low-income use.[3] Owners may either keep the projects and operate them under the federal rules or sell them to buyers who agree to do so; in general, owners are allowed to prepay their mortgages only if they want to sell but no buyers can be found who will preserve the project's low-income use, or if no federal funds are available to pay for incentives to preserve such use. The main incentive for preservation included in LIHPRHA is the higher rents owners will receive on units in their projects. The rent increases will be paid for primarily with increased federal subsidies, although some will come from increased payments by higher-income tenants. The cost of the federal subsidies could be substantial for many projects because the statute allows rents to increase to levels well above those subsidized by certain other housing programs.

Implementing the prepayment provisions comes at a time of particularly tight constraints on the federal budget, however. Between now and 1995, the Budget Enforcement Act (BEA) limits both budget authority and outlays for discretionary federal spending (that is, for spending determined each year by Congressional appropriation). Because of these limits, appropriations for housing aid will probably not increase much over the next few years.[4]

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3. See pages 18-23 for a more detailed description of the provisions of LIHPRHA designed to preserve these assisted projects.

4. The Congress has expressed its intent, however, to provide sufficient budget authority to continue aid to families whose Section 8 contracts--another form of housing assistance--are running out of funds. Renewing this aid alone is estimated to require budget authority of $7.8 billion in 1993 and $23.8 billion over the 1993-1995 period.

Consequently, if incentives to preserve housing for low-income use are funded for all eligible projects, the resources remaining for all other housing assistance will probably be even more limited. In particular, because the cost of simply maintaining the current number of assisted households has risen significantly in recent years, full funding will make it unlikely that many new households could be added to the rolls. Moreover, if funding levels for preservation incentives are not sufficient to preserve all projects, the Department of Housing and Urban Development (HUD) will need to decide which projects to preserve for low-income housing because the legislation does not establish such priorities.

To choose among these housing aid alternatives, the Congress could compare the costs of the prepayment provisions with other forms of housing aid and consider the impacts of alternative uses of federal housing resources on eligible tenants. After a brief overview of recent trends in federal housing aid, this memorandum examines these topics and explores options for allocating housing assistance. Much of the analysis is illustrative and is based on unpublished data provided by HUD. A more rigorous analysis of the issues awaits the collection of more complete data, which HUD is now doing.

TRENDS IN FEDERAL HOUSING ASSISTANCE

Housing aid has never been provided as an entitlement to all families who qualify for aid. Instead, each year the Congress appropriates funds for two broad purposes:

to provide new commitments to serve previously unaided families, and to renew and support existing commitments for aided families. Funds for the first purpose are termed incremental aid because they expand the total number of families receiving assistance. About 30 percent of eligible families currently receive housing aid, and incremental funding is used both to keep up with growth in the size of the eligible population and to increase the share that is served. Funds for the second broad purpose are called nonincremental aid. These funds are used mainly to extend the life of existing commitments, to maintain or restore the quality of existing structures, and to deepen aid to current recipients. Funds to prevent project owners from prepaying their mortgages are considered nonincremental aid because they seek to maintain existing assistance commitments.

The outlays that result from housing appropriations generally occur over many years. In most housing programs, funding is provided through appropriations of long-term budget authority for subsidies to households. The terms for commitments made today range from five to 20 years, but before 1982 they were as long as 40 years. In other housing programs, budget authority is appropriated for grants to entities who develop and rehabilitate assisted rental housing. Even the outlays resulting from grants occur over a long period because of lags involved in the construction and rehabilitation of projects. This pattern of long-term spending gives rise to a complicated relationship between the total number of assisted housing units, the outlays that support them, and the budget authority that creates them. As detailed below, it helps explain the apparent contradictory movements since 1977 of

growth in total assisted units and outlays on the one hand, and decline in budget authority on the other hand.

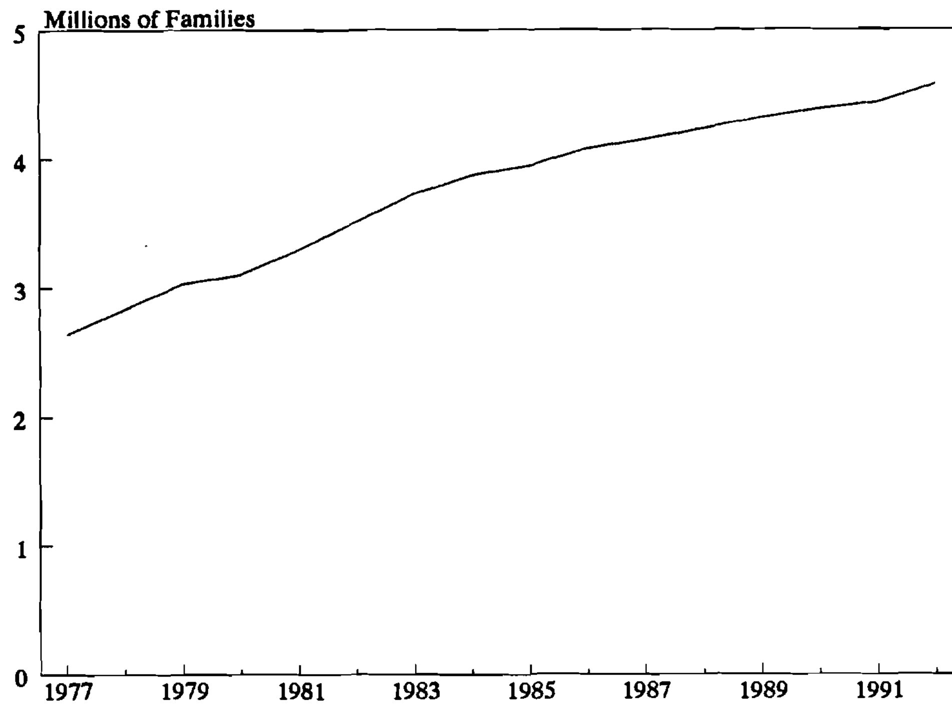
Both the number of families receiving housing aid and federal housing outlays generally have increased annually since 1977. Boosted by appropriations for incremental aid each year, the number of assisted families increased by 73 percent, rising from 2.6 million in 1977 to an estimated 4.6 million in 1992 (see Figure 1). Growth was more rapid during the first half of this period than the last, however, because cuts in annual appropriations for budget authority during the 1980s have, among other things, sharply decreased the number of new commitments added each year.

Outlays for housing assistance have also increased steadily since 1977.[5] Outlays grew by 180 percent, from $6.6 billion in 1977 to $18.6 billion in 1992, both measured in 1992 dollars (see Figure 2). This relatively rapid growth is explained not only by increases in the number of assisted families, but also by several factors that have increased real average subsidies. For example, during the early to mid-1980s many expensive, newly constructed units (funded from pre-1984 budget authority) became occupied, which contributed to the relatively high growth rate in outlays during that period.[6] Also, rents in assisted units have increased faster than

5. The bulge in outlays in 1985 resulted from a change in the method of financing public housing, which generated nearly $14 billion in one-time expenditures.

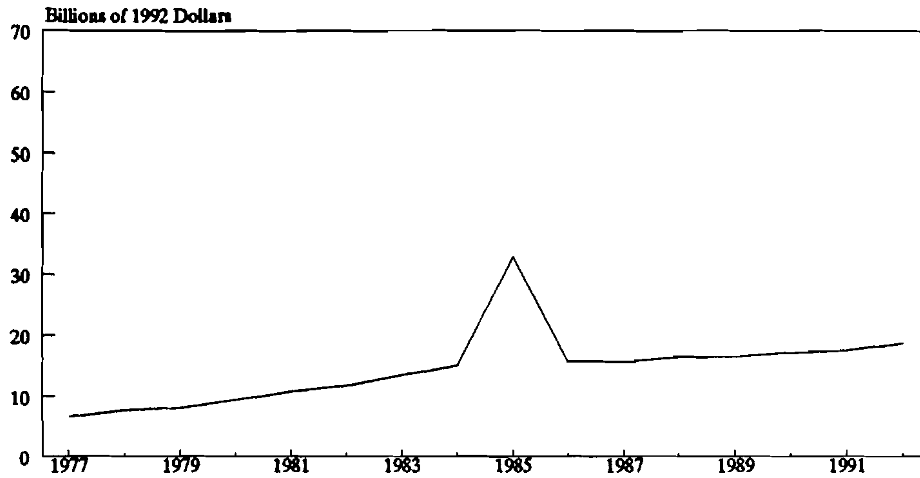
6. Before 1984, a large number of commitments were made under the Section 8 programs for new construction and substantial rehabilitation. Because of their high costs, these programs were discontinued in fiscal year 1984, except for a modest number of commitments each year for the elderly and the disabled.

Figure 1.
Number of Families Receiving Housing Aid,
End of Fiscal Years 1977–1992



SOURCE: Congressional Budget Office tabulations of budget documents of the Department of Housing and Urban Development, various years. See also Table A–1.

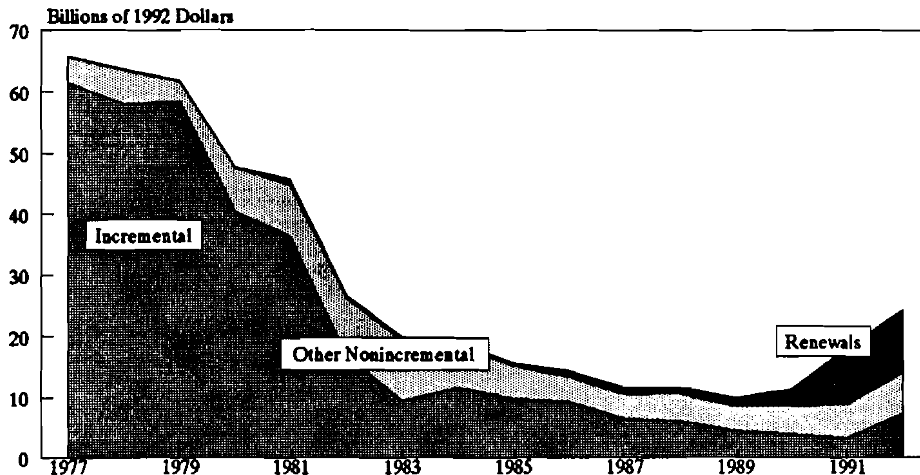
Figure 2.
Outlays for Housing Aid, 1977–1992



SOURCE: Congressional Budget Office tabulations of budget documents of the Department of Housing and Urban Development, various years. See also Table A–1.

NOTE: The bulge in outlays in 1985 resulted from a change in the method of financing public housing, which generated nearly $14 billion in one-time expenditures. Because of that expenditure, outlays for public housing since that time are roughly $1.4 billion (in nominal dollars) less each year than they would have been otherwise.

Figure 3.
Budget Authority for Housing Aid by Type of Use, 1977–1992



SOURCE: Congressional Budget Office tabulations of budget documents of the Department of Housing and Urban Development, various years. See also Table A–1.

NOTE: Renewals also include budget authority for amending contracts whose funds are exhausted before the end of the term of the contract.

tenants' incomes, thus increasing federal subsidies because those subsidies typically equal the difference between the units' rents and 30 percent of the tenants' incomes.

In contrast, real annual budget authority for housing aid has decreased sharply since the late 1970s, when several new housing programs were first funded, falling (in 1992 dollars) from $66 billion in 1977 to $10 billion in 1989 (see Figure 3). One contributing factor is the decline in the number of additional commitments funded each year, from around 300,000 per year in the late 1970s to less than 100,000 in 1989. Other factors--which do not affect the number of assisted units, at least in the short run--include the shift toward shorter commitment terms, cheaper forms of aid (through the use of existing housing rather than new construction), and, since 1987, changes in the method of financing new construction and modernization programs.[7] In particular, reducing the terms of assistance (for example, from 15 to five years) decreases the amount of budget authority needed in the short term to provide assistance to a given number of units. This budget authority will need to be renewed more frequently, however, so that the total amount of resources required over a longer period of time remains unchanged.

Through most of the 1980s, annual outlays grew despite decreases in budget authority because most outlays in any given year are derived from past appropriations of budget authority. In recent years, however, the growth in outlays

7. Before 1987, construction and modernization of public housing was financed over periods from 20 to 40 years, with budget authority reflecting principal and interest payments on this debt. Now these activities are financed with grants, which reduces budget authority requirements between 51 percent and 67 percent. In 1985, most of the outstanding debt incurred for activities since 1974 was paid off, causing the bulge in outlays shown in Figure 2 and reducing outlays since that time by about $1.4 billion per year.

stems increasingly from new appropriations for nonincremental aid, as existing commitments are running out of budget authority and as funds are needed to rehabilitate the aging assisted stock.

Given the overall decline in budget authority for housing aid, the relative growth of nonincremental aid is crowding out funds for incremental aid. For example, between 1985 and 1989, when real budget authority declined by 37 percent, nonincremental aid fell only 6 percent and incremental aid fell 55 percent. Between 1989 and 1991, incremental aid continued to decline, but total budget authority increased sharply, mostly because of the need to fund expiring assistance commitments. Incremental aid nearly doubled between 1991 and 1992 because of special factors that apply only to that year.[8]

If the LIHPRHA provisions are fully funded over the next several years at the levels estimated by HUD--requiring close to $4 billion in budget authority between 1993 and 1995 alone--the remaining housing funds could be severely squeezed. For instance, if total housing aid is funded at the 1992 appropriation level (plus adjustments for inflation), and if the renewals of existing commitments are funded at their required levels, then the budget authority remaining for incremental housing aid could fall to an all-time low of $1.3 billion in 1994. Moreover, if housing programs are funded below the inflation-adjusted 1992 level to conform to the

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8. Much of the budget authority for incremental aid came from unusually large amounts of unused budget authority carried over from previous years (more than $3 billion) or freed up by the 1991 change in the financing method of the Section 202 program for the elderly and the disabled ($1.3 billion). Such funding sources are unlikely to be available in the next few years.

spending limits imposed by the BEA, then funding for incremental aid would be reduced even further. Although such an outcome would nearly halt the number of new assisted-housing commitments, it would do so after more than a decade of substantial growth in the number of aided families and real outlays. This pattern contrasts with that of many other domestic discretionary programs, whose real outlays remained steady or declined during the 1980s.

POTENTIAL IMPACTS OF PREPAYMENT PROVISIONS ON TENANTS' RENT PAYMENTS AND FEDERAL SUBSIDIES

This section examines the potential impacts of LIHPRHA's prepayment provisions on tenants' rent payments and federal subsidies paid on their behalf. Because these provisions are very complex, the analysis simplifies certain aspects and concepts contained in the legislation. These simplifications do not, however, affect the basic results. The analysis focuses on Section 236 projects, which represent almost three-quarters of the total stock eligible for prepayment; much of the qualitative aspects of the analysis, however, can also be applied to Section 221(d)(3) projects. Box 1 contains a description of these and related housing programs.

Profile of Section 236 Projects with Mortgages Eligible for Prepayment

Federal housing aid generally is restricted to low-income families, defined as those whose income does not exceed 80 percent of the area median, adjusted for family

Box 1.
Housing Programs Involved in the Prepayment Issue

Several types of housing programs administered by the Department of Housing and Urban Development (HUD) are involved in the prepayment issue. One type of program provides project owners with subsidies to reduce their mortgage payments and, in most cases, with mortgage insurance through the Federal Housing Administration (FHA). A second type provides supplementary aid either for some of the lowest-income tenants in the projects or for the projects themselves that are under financial strain. Aid in both types of programs is tied to the projects. A third type of program provides aid that is tied not to a project but to tenants; that is, tenants generally may use it in a unit of their choosing. Programs of this type will assist tenants vacating projects whose owners prepay their mortgages. (Also see Box 2 for definitions of the various types of rents discussed below.)

Mortgage-Payment Subsidies

Section 221(d)(3) Below Market Interest Rate (BMIR) Program. Between 1961 and 1968, the Section 221(d)(3)BMIR program gave project owners a one-time, up-front subsidy that effectively lowered the interest rate on their 40-year mortgages to 3 percent. To live in these projects, families' income at the time they move in may not exceed 95 percent of the area median, adjusted for family size. Traditionally, tenants have paid a fixed rent that covers payments on the 3 percent mortgage, operating costs, plus (for for-profit owners) a 6 percent pretax return on their original investment. Under the Cranston-Gonzalez Act of 1990, however, tenants whose current income exceeds 80 percent of the area median must pay the lesser of 30 percent of their income or the Section 8 existing-housing fair market rent (FMR).

Section 236 Program. The Section 236 program, which replaced the Section 221(d)(3)BMIR program in 1968, provides private lenders with monthly payments sufficient to lower the effective mortgage interest rate on a 40-year mortgage to 1 percent. Although no new commitments have been made since 1973, outlays for these subsidies continue today. To live in a Section 236 project, families' income at the time they move in may not exceed 80 percent of the area median income, adjusted for family size. Tenants must pay 30 percent of their adjusted income or the FHA-controlled rent, whichever is higher; in any case, they are not required to pay more than the fair market rental charge. Since enactment of the Cranston-Gonzalez Act, however, tenants whose current income exceeds 80 percent of the area median income must pay the lesser of 30 percent of their income and the Section 8 existing-housing FMR (see Box 2). Amounts collected by the owners above the FHA-controlled rent revert to HUD.

(Continued)

Box 1. (Continued)

Supplementary Assistance

Section 8 Project-Based Rental Assistance Program. Starting in 1976, the Section 8 program has paid project owners, on behalf of certain tenants, the difference between 30 percent of the tenants' income and the fixed rent or the FHA-controlled rent (in Section 221(d)(3)BMIR and 236 projects, respectively). This supplementary aid has made rents more affordable to some of the poorer tenants in these projects. Section 8 aid has also been used to assure a steady stream of rental income for projects in financial distress, thus preventing claims on the FHA insurance funds. Before 1984, budget authority for this assistance was committed for 15 years, and since then for five years.

Flexible Subsidy Program. Authorized in 1978, this program provides financially troubled projects with cash grants or low-interest loans to fund deferred maintenance and rehabilitation needs and operating deficits and to provide replacement reserves to meet future needs. Since 1983, the program has been financed mostly from funds collected from Section 236 tenants who pay more than the FHA-controlled rent.

Tenant-Based Assistance

Section 8 Existing-Housing Rental Certificate Program. This Section 8 program, authorized in 1974, provides rental assistance to income-eligible families; they can rent any existing housing units that meet property standards set by HUD and whose rents generally do not exceed the Section 8 existing-housing FMR. HUD pays the difference between 30 percent of the family's adjusted income and the unit's actual rent. Traditionally, budget authority was committed for 15 years, but since 1989 it has generally been committed for five years.

Section 8 Voucher Program. Authorized in 1983, the voucher program is similar to the rental certificate program in that families can rent any units that meet HUD's property standards. However, families may occupy units with rents exceeding the FMR if they pay the difference, and they may keep the difference if rents are below the FMR. Funding has always been committed for five years.

size.[9] Under current policy, however, families can continue to receive aid if their income surpasses that level after admission to a particular program. The primary target group for federal aid is families with very low income, defined as those whose income does not exceed 50 percent of the area median.[10] According to data from the 1989 American Housing Survey, about 80 percent of all assisted families are in this category.

Both the Section 236 and the Section 221(d)(3) programs serve tenants who are somewhat better-off, on average, than those served by most other federal housing programs. For instance, about 30 percent of families living in Section 236 projects have income above 50 percent of the area median. About 6 percent of the families in these projects would be ineligible for most housing aid if they applied today, because their income now exceeds 80 percent of the area median.

Section 236 projects have complex rent structures. The total rent for a given unit, which is paid with a combination of federal subsidies and tenants' payments, is the *fair market rental charge*. (See Box 2 for definitions of various types of rent.) This rent is based on four cost components: a federal subsidy to the mortgage lender to reduce the interest rate on the project's mortgage, the owner's mortgage payments, the project's operating costs, and (for an owner that is a for-profit entity) a 6 percent rate of return on the owner's original investment.

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9. For the Section 221(d)(3) program, families with income up to 95 percent of the area median income are eligible to apply.

10. Using HUD's estimate of nationwide median family income as a benchmark, a family of four was considered "very-low-income" in 1991 if its income was below $19,000, or 1.4 times the poverty level for a family of that size. In practice, however, this limit varies by location.

Box 2.
Types of Rent Related to the Issue of Mortgage Prepayments

Rents Not Specific to LIHPRHA

FHA-controlled rent (or Basic rent): Before enactment of the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA), the minimum rent paid by low-income tenants in Section 236 projects who do not receive any supplementary federal housing aid. Also, the amount of rent that owners may keep, with any additional sums paid by tenants going to the Department of Housing and Urban Development. This rent is determined by project operating expenses, the amount needed to amortize a 1 percent mortgage on the project, and (in the case of for-profit owners) an allowance for a 6 percent rate of return on the owners' investment.

Fair market rental charge: Before LIHPRHA, the maximum rent paid by higher-income tenants in Section 236 projects. Similar to the Federal Housing Administration's controlled rent, except it includes a component to amortize the full cost of the mortgage, not the subsidized (1 percent) cost.

Section 8 existing-housing fair market rent (or FMR): Generally, the maximum rent that HUD subsidizes in the Section 8 existing-housing program. The FMR now also serves as the maximum rent to be paid by higher-income tenants in projects receiving prepayment incentives.

Alternative market rent: Rent that a unit could command in the private rental market.

Rents Specific to LIHPRHA

Extension rent: Rent potentially received by a current owner of a project that continues in the program. Designed to provide an owner with an 8 percent return on equity that could be liquidated if the project were sold for private rental housing.

Transfer rent: Rent potentially received by a buyer of a project that continues in the program. Similar to the extension preservation rent except that it is based partly on the value of the project in its highest and best alternative use (not necessarily as rental housing).

Federal cost limit: The upper limit on rent received by the owner of a project that continues in the program. If the extension rent exceeds this limit and the current owner keeps the project, the rent received by the owner is reduced. If the transfer rent exceeds it and the project is sold, a federal grant may be provided to a buyer to reduce rents.

Preservation rent (or Plan of action rent): Rent actually received by the owner of a project after accounting for tenants' payments and preservation incentives.

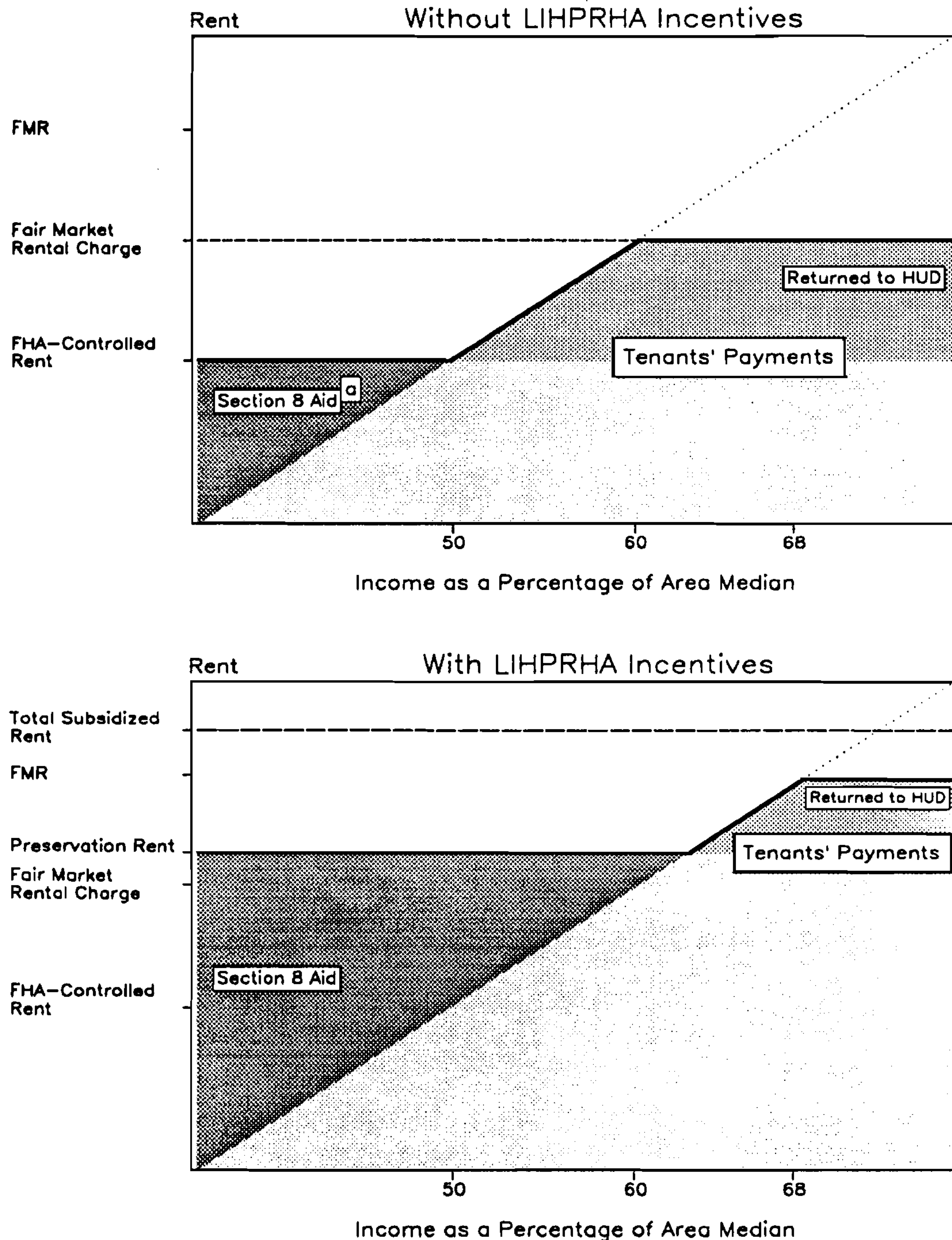
Total subsidized rent: Total amount paid on behalf of a unit receiving preservation incentives. It consists of the preservation rent plus any mortgage subsidy paid by the federal government.

Tenants pay 30 percent of their income toward this total, with two exceptions. First, tenants for whom 30 percent of income does not equal at least a minimum amount, termed the *FHA-controlled rent* or the *basic rent*, must either pay the basic rent themselves or obtain additional federal assistance in the form of Section 8 aid to do so. The basic rent is determined by the last three cost components listed above--the owner's mortgage payments, the project's operating costs, and a 6 percent return on the owner's investment. The second exception to the 30 percent rule is that tenants for whom 30 percent of income exceeds the fair market rental charge for their unit need pay only that charge. The top panel of Figure 4 illustrates the relationship between these rents and income.

Project owners keep only the basic rent, however. Excess rental collections are returned to the government and are typically used to help fund the flexible subsidy program.

The fair market rental charge may be higher or lower than the *market rent* as it is usually defined--namely, the going rate for similar units in the area. The relationship between the two concepts depends mostly on whether market conditions have deteriorated or improved since the project was built. Similarly, the fair market rental charge is distinct from the *Section 8 existing-housing fair market rent*, or *FMR*, which is the maximum rent that HUD subsidizes in the Section 8 existing-housing certificate and voucher programs.

FIGURE 4. RELATIONSHIPS BETWEEN TENANTS' INCOME AND RENTS IN A TYPICAL SECTION 236 PROJECT, WITHOUT AND WITH LIHPRHA INCENTIVES



SOURCE: Congressional Budget Office.

NOTES: For ease of presentation, these figures are not drawn to scale. The diagonal line represents 30 percent of tenants' income.

The difference between the fair market rental charge and the FHA-controlled rent (in the top panel) and between the total subsidized rent and the preservation rent (in the bottom panel) is the federal mortgage subsidy.

LIHPRHA = Low-Income Housing Preservation and Resident Homeownership Act; FMR = fair market rent; HUD = Department of Housing and Urban Development; FHA = Federal Housing Administration; Preservation rent = rent received by owner.

a. In this case, federal Section 8 aid is provided to some, but not all, tenants.

The rent structure in Section 236 projects gives rise to an uneven distribution of rent-to-income ratios, as illustrated for a typical project in Table 2. Although the majority of tenants pay 30 percent of their income for rent, some of the poorest tenants--about 23 percent of all tenants--pay well over 30 percent of their income for rent. By contrast, 18 percent of all tenants, those with income above 59 percent of the area median, pay less than 30 percent of their income for rent because of the rent caps. (In Table 2, this group of tenants is broken into three subgroups because those subgroups receive different treatment under the prepayment incentives analyzed below.)

Current federal subsidies per family also vary substantially across the income categories. These subsidies include Section 8 aid, which averages about $2,300 per year for the 47 percent of tenants receiving it, and mortgage subsidies, which average $907 per unit. The latter are paid to lenders on behalf of all units in Section 236 projects. However, for about 30 percent of the units--those occupied by the highest-income tenants--part or all of the mortgage subsidy is recaptured by HUD because their rent payments exceed the basic rent.

A Simplified Overview of the Prepayment Provisions

Under the LIHPRHA provisions, current owners of prepayment-eligible projects

TABLE 2. CHARACTERISTICS OF A TYPICAL SECTION 236 PROJECT ELIGIBLE FOR MORTGAGE PREPAYMENT, 1991

Tenant's Gross Income Relative to Area Median	Percentage of All Tenants	Tenant's Adjusted Annual Income (Dollars)	Estimated Range for Tenant's Annual Rent Payment: Dollars	Estimated Range for Tenant's Annual Rent Payment: As a Percentage of Income	Total Annual Federal Subsidy (Dollars)
Less Than 50 Percent[a]					
With Section 8	47	Less than 15,120	Less than 4,536	30	More than 907
Without Section 8	23	Less than 15,120	4,536	More than 30	907
50 Percent to 59 Percent[b]	12	15,120 to 18,143	4,536 to 5,443	30	907 to 0
60 Percent to 67 Percent[c]	6	18,143 to 20,880	5,443	30 to 26	0
68 Percent to 80 Percent[d]	6	20,880 to 25,090	5,443	26 to 22	0
Greater Than 80 Percent[e]	6	More than 25,090	5,443	Less than 22	0

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTES: The following parameters (measured in dollars on an annual basis) were used in these calculations:

Parameter	Dollars
Average Section 236 FHA-Controlled Rent	4,536
Average Mortgage Subsidy	907
Average Section 236 Fair Market Rental Charge	5,443
Average Local Section 8 Existing-Housing Fair Market Rent (Maximum rent subsidized by HUD in the Section 8 existing-housing program)	6,264
Median National Income for Family of 2.5 Persons	32,300
Average Income Adjustments	750

FHA = Federal Housing Administration.

a. For these tenants, 30 percent of their adjusted income is less than the FHA-controlled rent. Those with Section 8 aid pay 30 percent of their adjusted income; those without it pay the higher FHA-controlled rent.

b. Tenants pay 30 percent of their adjusted income, which equals or exceeds the FHA-controlled rent but is less than the fair market rental charge (FHA-controlled rent plus mortgage subsidy).

c. Tenants pay the fair market rental charge, which is less than or equal to 30 percent of their adjusted income and less than the local Section 8 existing-housing fair market rent.

d. Tenants could pay the local Section 8 existing-housing fair market rent with 30 percent or less of their adjusted income.

e. Tenants would be ineligible for Section 8 aid and most other housing aid if they applied today.

effectively have two choices: retain their projects for low-income rental use, or sell them to buyers who agree to preserve that use.[11]

If the current owner decides to keep the project, then the rent he or she receives may be raised under LIHPRHA to an amount, termed--in this memorandum--the preservation rent, that is the lesser of the following:[12]

- The *extension rent*, which is an amount sufficient to support payments on the Section 236 mortgage at the subsidized rate; plus payments for repair loans, project reserves, and operating costs; plus an 8 percent return on current equity, calculated as the difference between the value of the project as market rental housing and all outstanding mortgage debts;[13] and

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11. A third choice, to prepay the mortgage and terminate the use restrictions, can be approved by HUD only under very limited circumstances.

12. The discussion on pages 20-22 is intended to convey only the basic principles of the complex LIHPRHA provisions, rather than all of the technical details. In particular, the definitions of various rent concepts used here vary somewhat from the definitions used in the statute. In this memorandum, the term preservation rent denotes the actual rent received by the owner or buyer of a project under the LIHPRHA provisions. The statute, however, makes a specific distinction between the terms "aggregate preservation rent"--which is the initial assessment of aggregate project income that will be needed to support preservation costs, and which is compared with the federal cost limit to determine what courses of action are open to the owner--and "actual rent received" (also referred to by some as the "plan of action rent"), which is determined after the owner's plan of action is approved. Thus, the actual rent could differ from the preservation rent (as used in the statute), although most of the cost components are identical. For example, to compute the preservation rent (as used in the statute), the component for payments for repair loans is calculated assuming a market-interest rate and a customary loan term. If, in reality, an owner or buyer obtained a repair loan at a below-market-interest rate or with a longer than customary term (for example, from a State Housing Finance Agency), the payments for repair loans would be lower and the actual rent would be less than the preservation rent (as used in the statute).

13. Instead of realizing increased returns over time, the owner may choose to obtain an equity takeout loan. Such loans are restricted to the lesser of 70 percent of the equity or an amount supportable by payments equal to 8 percent of equity.

- The *federal cost limit*, which equals the greater of 120 percent of the local FMR and 120 percent of the prevailing market rent for similar units in the neighborhood.

If the preservation rent is constrained by the federal cost limit, the current owner will generally receive a rate of return on equity below 8 percent (but will also postpone paying taxes that would be due if the project were sold).

Under the incentives authorized by LIHPRHA, part of the increased rent would come from increased payments by some tenants and part from increased federal subsidies. The latter include increased Section 8 subsidies for tenants already receiving this aid plus new Section 8 subsidies for eligible but currently unassisted tenants.[14]

If the current owner decides to sell the project and a buyer is found who agrees to preserve the low-income use, the owner will receive the full equity in the project, calculated in this case as the difference between the value of the project in its highest and best use (not necessarily as rental housing) and the balance on the Section 236 mortgage. To facilitate this sale, LIHPRHA authorizes for the buyer the same types of incentives the owners have. In this case, however, the preservation rent the buyer may receive will equal the lesser of the federal cost limit described above and the *transfer rent*. The latter is similar to the extension rent

14. Preservation rents could be reduced by some other incentives authorized in the statute, including subsidized or insured repair loans. Such subsidies would reduce the level of Section 8 aid but would probably not eliminate the need for it.

except that the allowance for the 8 percent return on current equity is replaced by a typically larger amount. This larger amount includes the sum needed to provide the buyer with an 8 percent return on the down payment made on the project, plus the amount the buyer needs to make mortgage payments on the additional loan taken out to pay the former owner. The additional loan, termed an acquisition loan, is equal to what the former owner receives for the project (that is, the project's value at its highest and best use less the balance on the outstanding Section 236 mortgage, which transfers to the new owner) less the down payment made by the buyer. If the transfer rent exceeds the federal cost limit, the buyer may receive a federal grant to reduce the size of the acquisition loan sufficiently so that the rent actually received just equals the federal cost limit.

Note that the definition of preservation rent in these two instances excludes the federal mortgage subsidy on the original project loan. This exclusion implies that the rent level that is actually subsidized by HUD will equal the preservation rent plus the mortgage subsidy. This sum, referred to here as the *total subsidized rent*, could be well in excess of the federal cost limit.

If no buyer can be found, or if sufficient funds have not been appropriated to pay for the incentives described above, then the owner is allowed to prepay the mortgage and drop out of the program. If the owner exercises this option, federal aid (in the form of Section 8 certificates or vouchers) will be provided to income-

eligible displaced tenants to the extent that appropriations for such aid are available.[15] However, the owners are required to extend for three years the leases of current tenants with special needs, including the elderly and disabled, and of all current tenants in areas with low vacancy rates.

Illustrative Impacts of Preservation Incentives on Tenants' Rent Payments

Providing incentives to preserve a project's low-income use under LIHPRHA will decrease the rents paid by some tenants, increase them for others, and leave them unchanged for a third group. Under LIHPRHA, current tenants will generally pay 30 percent of their adjusted income, but not more than the local FMR. Any difference between the preservation rent and the tenants' payments will be paid for by increasing Section 8 aid for tenants already receiving it and by providing new aid for all other tenants whose income does not exceed 80 percent of the area median. The bottom panel of Figure 4 (on page 17) depicts the relationship between tenants' incomes and project rents under the LIHPRHA provisions.

Thus, how preservation incentives will affect tenants' rent payments depends on their income level and on whether or not they were previously receiving Section 8 aid (see Table 3). Tenants who already receive Section 8 aid and those who already pay 30 percent of their income in rent will not be affected; those two groups

15. The statute directs HUD to set aside the necessary funding from appropriations earmarked for preservation incentives or from annual appropriations for other housing assistance programs.

TABLE 3. ILLUSTRATIVE IMPACT OF PRESERVATION INCENTIVES ON THE ANNUAL RENT PAYMENTS OF TENANTS IN A TYPICAL SECTION 236 PROJECT

Tenant's Gross Income Relative to Area Median	Tenant's Average Annual Rent Payment: Without LIHPRHA Incentives (Dollars)	With LIHPRHA Incentives (Dollars)	Change (Percent)	Rent as a Percentage of Income: Without LIHPRHA Incentives	With LIHPRHA Incentives	Change (Percentage points)
Less Than 50 Percent[a]						
With Section 8	2,198	2,198	0	30	30	0
Without Section 8	4,536	2,198	-52	62	30	-32
50 Percent to 59 Percent[b]	4,990	4,990	0	30	30	0
60 Percent to 67 Percent[c]	5,443	5,854	8	28	30	2
68 Percent to 80 Percent[d]	5,443	6,264[e]	15	24	27[e]	3
Greater Than 80 Percent[f]	5,443	6,264[e]	15	20	23[e]	3

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTE: Figures are calculated for 1991.

LIHPRHA = Low-Income Housing Preservation and Resident Homeownership Act

a. For these tenants, 30 percent of their adjusted income is less than the Federal Housing Administration's (FHA's) controlled rent. Without LIHPRHA incentives, those with Section 8 aid pay 30 percent of their adjusted income and those without it pay the higher FHA-controlled rent.

b. Tenants pay 30 percent of their adjusted income, which equals or exceeds the FHA-controlled rent but is less than the fair market rental charge (FHA-controlled rent plus mortgage subsidy).

c. Without LIHPRHA incentives, these tenants pay the fair market rental charge, which is less than or equal to 30 percent of their adjusted income and less than the local Section 8 existing-housing fair market rent.

d. Tenants could pay the local Section 8 existing-housing fair market rent with 30 percent or less of their adjusted income.

e. Reflects stipulation that tenant payments cannot exceed Section 8 existing-housing fair market rent. Rent increases would be phased in, subject to a limit of 10 percent a year on the rate of increase.

f. Tenants would be ineligible for Section 8 aid and most other housing aid if they applied today.

total 59 percent of all tenants now in the affected projects. In a typical project, tenants who previously spent more than 30 percent of their income for rent and did not receive Section 8 aid will see their rent payments reduced, on average, by 52 percent; their average rent-to-income ratios will fall from 62 percent to 30 percent. By contrast, the highest-income tenants in a typical project will face average rent increases of up to 15 percent. Two-thirds of them will continue to pay less than 30 percent of their income for rent, however, because of the FMR caps. These averages mask much higher rent increases faced by higher-income tenants in some projects, however. Anecdotal evidence suggests that rent payments by some of these tenants will increase as much as 30 to 35 percent.

The new rents paid by tenants will generally not depend on the level of the preservation rent. Under the new scheme, Section 8 aid will allow tenants to pay 30 percent of their income in rent, but typically no more than the FMR.[16] Federal subsidies do depend on the preservation rent, however, as described in the next section.

The Potential Impacts of Preservation Incentives on the Federal Budget

The potential impacts of the preservation incentives on the federal budget are determined by the level of the preservation rent because federal subsidies would pay

16. In some projects, with sufficiently low preservation rents, the rent paid by some tenants could be less than the FMR and less than 30 percent of their income.

the difference between that rent and the tenants' payments. This section illustrates a range of potential costs of the LIHPRHA provisions for a typical Section 236 project by considering three scenarios for the level of rent received by the project's owner, that is, the preservation rent:

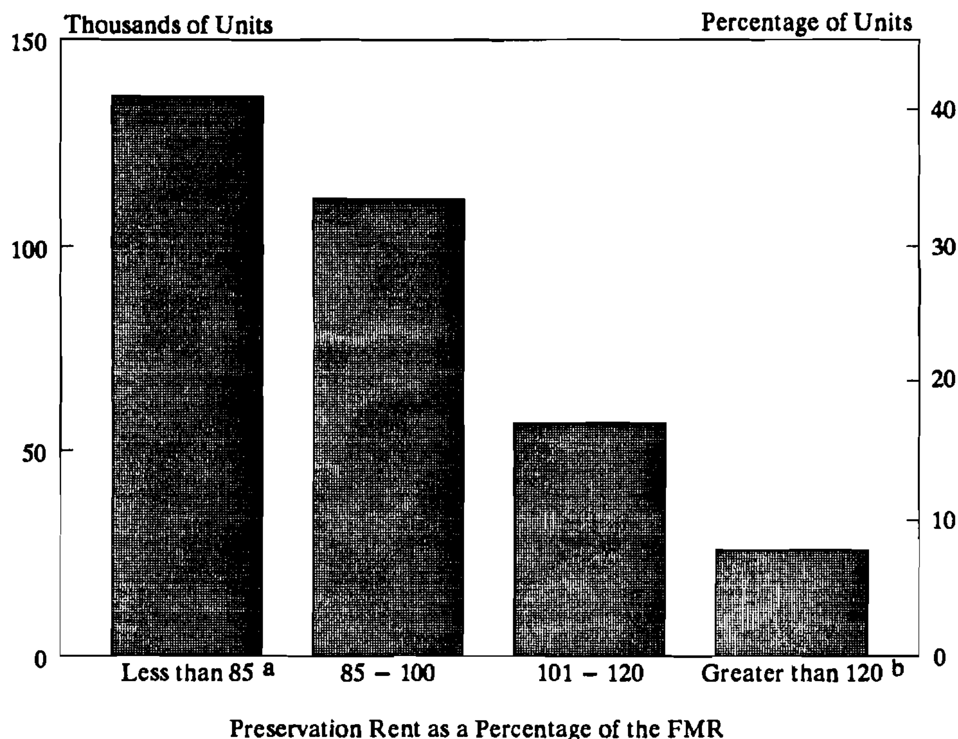
- The first, and most expensive, scenario illustrates the cost of preserving a project whose preservation rent is 120 percent of the FMR. This amount equals the federal cost limit for most projects and thus illustrates the maximum cost of the LIHPRHA provisions for those projects.

- The second scenario illustrates the cost of preserving an assisted project whose preservation rent equals the FMR. This case is useful because the FMR is the maximum rent that may be subsidized with federal housing vouchers.

- The third scenario illustrates the cost of preserving an assisted project whose preservation rent is about 85 percent of the FMR. This amount is shown below to be the break-even point--the point at which the cost of preserving an average unit equals the cost of providing a voucher.

Preliminary estimates of the shares of prepayment-eligible units in various rent categories defined by these three preservation rent levels are shown in Figure 5.

Figure 5.
Distribution of Prepayment Eligible Units by Estimated Preservation Rent as a Percentage of the Fair Market Rent



SOURCE: Congressional Budget Office calculations based on estimates provided by the Department of Housing and Urban Development. See also Table A-2.

NOTES: Preservation rent = rent received by owner.

Excludes 26,645 units that HUD estimates will convert to home ownership.

Estimates of the preservation rents and the corresponding distribution of units should be considered with great caution because of the uncertainty regarding the actual preservation rents of these projects. These rents cannot be determined accurately until the projects are appraised. Thus, the actual distribution may differ considerably from that shown here.

a. HUD estimates that most of these units currently have no prepayment potential because of relatively low alternative market rents.

b. HUD estimates that prepayment will take place for about 7,000 of these units because their preservation rents exceed both 120 percent of the prevailing rents in the neighborhood and 120 percent of the local fair market rent.

About 60 percent of all units in projects eligible to prepay are estimated to have preservation rents exceeding 85 percent of the FMR, the level used in the third scenario. According to HUD's estimates, the lion's share of the remaining 40 percent of units have no prepayment potential because the alternative market rent that they could command is insufficient to cover the cost the project would incur if the mortgage had to be refinanced at a market interest rate.[17]

Under each of the above three scenarios, the average federal subsidy received by tenants would be considerably greater than their current average subsidy. For projects at the federal cost limit (the first scenario), the subsidy would average about $5,100 per tenant--nearly three times the current subsidy of about $1,800. Average subsidies in the other two scenarios would be smaller--at $3,900 and $3,000 per tenant, respectively--but would still be well above the current average.

Scenario One. The first scenario assumes that the preservation rent equals the typical federal cost limit of 120 percent of the local FMR. This cost limit is estimated to average $7,517 in 1991 in areas where the prepayment-eligible stock is located (see Table 4). Such a rent level would represent a 66 percent increase relative to the basic rent currently received by the owner of a typical Section 236 project. Raising rents to this level would have several implications. First, because of the mortgage subsidy, the total subsidized rent would amount to $8,424, or 134 percent of the average FMR. Second, because the maximum tenant payments

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17. Many of these units may be financially troubled and may require additional subsidies to prevent owners from defaulting on their FHA-insured mortgages. Such subsidies would not be made available through LIHPRHA, however.

TABLE 4. ILLUSTRATIVE IMPACT ON THE FEDERAL BUDGET OF PRESERVATION INCENTIVES, UNDER ALTERNATIVE ASSUMPTIONS ABOUT THE LEVEL OF PRESERVATION RENT

	Federal Subsidy per Tenant in First Year			Funds Recaptured for Flexible Subsidy Program in First Year[b]	
Tenant's Gross Income Relative to Area Median	Without LIHPRHA Incentives (Dollars)	With LIHPRHA Incentives[a] (Dollars)	Change (Percent)	Without LIHPRHA Incentives (Dollars)	With LIHPRHA Incentives (Dollars)
Scenario One: Preservation Rent Equals 120 Percent of the FMR					
Less Than 50 Percent[c]					
With Section 8	3,246	6,227	92	0	0
Without Section 8	907	6,227	586	0	0
50 Percent to 59 Percent[d]	454	3,434	657	453	0
60 Percent to 67 Percent[e]	0	2,570	n.a.	907	0
68 Percent to 80 Percent[f]	0	2,160	n.a.	907	0
Greater Than 80 Percent[g]	0	907	n.a.	907	0
Scenario Two: Preservation Rent Equals the FMR					
Less Than 50 Percent[c]					
With Section 8	3,246	4,974	53	0	0
Without Section 8	907	4,974	448	0	0
50 Percent to 59 Percent[d]	454	2,182	381	453	0
60 Percent to 67 Percent[e]	0	1,318	n.a.	907	0
68 Percent to 80 Percent[f]	0	907	n.a.	907	0
Greater Than 80 Percent[g]	0	907	n.a.	907	0

(Continued)

TABLE 4. (Continued)

Tenant's Gross Income Relative to Area Median	Federal Subsidy per Tenant in First Year: Without LIHPRHA Incentives (Dollars)	Federal Subsidy per Tenant in First Year: With LIHPRHA Incentives[a] (Dollars)	Change (Percent)	Funds Recaptured for Flexible Subsidy Program in First Year[b]: Without LIHPRHA Incentives (Dollars)	Funds Recaptured for Flexible Subsidy Program in First Year[b]: With LIHPRHA Incentives (Dollars)
Scenario Three: Preservation Rent Equals 85 Percent of the FMR[h]					
Less Than 50 Percent[c]					
With Section 8	3,246	4,067	25	0	0
Without Section 8	907	4,067	348	0	0
50 Percent to 59 Percent[d]	454	1,274	181	453	0
60 Percent to 67 Percent[e]	0	410	n.a.	907	497
68 Percent to 80 Percent[f]	0	0	n.a.	907	907
Greater Than 80 Percent[g]	0	0	n.a.	907	907

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTES: Figures are calculated for 1991. To simplify the analysis, all estimates assume a zero percent vacancy rate.

Preservation rent = rent received by owner; LIHPRHA = Low-Income Housing Preservation and Resident Homeownership Act; FMR = fair market rent; n.a. = not applicable.

a. Includes ongoing and new Section 8 subsidies and mortgage subsidies.
b. These funds represent rent collections by the owner in excess of the FHA-controlled or preservation rent. (See Box 1 for a description of the flexible subsidy program.)
c. For these tenants, 30 percent of their adjusted income is less than the FHA-controlled rent. Without LIHPRHA incentives, those with Section 8 aid pay 30 percent of their adjusted income and those without it pay the higher FHA-controlled rent.
d. Tenants pay 30 percent of their adjusted income, which equals or exceeds the FHA-controlled rent but is less than the fair market rental charge (FHA-controlled rent plus mortgage subsidy).
e. Without LIHPRHA incentives, these tenants pay the fair market rental charge, which is less than or equal to 30 percent of their adjusted income and less than the local Section 8 existing-housing fair market rent.
f. Tenants could pay the local Section 8 existing-housing fair market rent with 30 percent or less of their adjusted income.
g. Tenants would be ineligible for Section 8 aid and most other housing aid if they applied today.
h. This rent level is roughly equivalent to the FMR minus the mortgage subsidy.

(equaling the FMR) do not even cover the preservation rent, much less any of the mortgage subsidy, full mortgage subsidies would now benefit all tenants, including those with income above 80 percent of the area median. Therefore, no funds would be recouped for the flexible subsidy program. Third, all income-eligible tenants would receive Section 8 aid to cover the difference between the preservation rent and 30 percent of their income.[18] Fourth, total subsidies would almost double for tenants already receiving Section 8 aid and would increase more than sevenfold for some other tenants.

Scenario Two. The second scenario assumes that the preservation rent equals the FMR, a 38 percent increase relative to the current basic rent (see Table 4). In this case, the total subsidized rent would be 114 percent of the FMR. Again, no funds would be recouped for flexible subsidies because the maximum tenant payment covers the preservation rent but none of the mortgage subsidy. However, new Section 8 aid would not be provided to income-eligible tenants whose income is above 67 percent of the area median because 30 percent of their income exceeds the preservation rent. Finally, total subsidies would increase more than 50 percent for tenants already receiving Section 8 aid and more than five times for some others.

Scenario Three. The third scenario assumes that the preservation rent equals the FMR minus the mortgage subsidy. This rent level is about 85 percent of the FMR

18. For tenants whose income exceeds 80 percent of the area median, LIHPRHA does not allow HUD to cover the shortfall between the preservation rent and their rent payments, which are limited by the local FMR. In practice, however, this shortfall would probably be added to the subsidies provided on behalf of income-eligible tenants, effectively increasing the Section 8-subsidized rent somewhat above the per-unit preservation rent. (This possibility is not reflected in Table 4, but is illustrated in Appendix A, Table A-3.)

and would be 18 percent higher than the current basic rent (see Table 4). The total subsidized rent would equal the FMR under this scenario. Rent payments by 18 percent of the tenants--those with the highest income--would exceed the preservation rent, thus enabling the federal government to recapture part or all of their mortgage subsidies for the flexible subsidy program. Moreover, Section 8 aid would not be needed for this group of tenants. Yet even this relatively modest level of preservation rent would generate an average increase of 25 percent in total subsidies for tenants already receiving Section 8 aid and an increase of more than 300 percent for some others.[19]

RELATIVE COSTS OF PRESERVATION INCENTIVES AND VOUCHERS

By establishing relatively high limits for allowable preservation rents and by authorizing grants to reduce preservation rents to these cost limits when the most valuable properties are sold, the Congress has indicated its intent that all properties eligible for prepayment be preserved as assisted housing. This section compares the potential five-year cost of preserving certain projects with that of allowing prepayment to take place and providing vouchers to displaced residents.

19. Table A-3 presents a summary of the components of the total subsidized rent under the three scenarios. It shows where the rental payments come from (the tenants, Section 8 subsidies, and Section 236 subsidies) and who ultimately receives them (the owner, the bank, and the Flexible Subsidy Fund).

The costs of preservation and vouchers can be compared in terms of budget authority or outlays. As shown below, however, although outlays provide a fairly accurate measure of the total cost of each of these forms of housing aid, budget authority does not.[20] In particular, the amount of budget authority needed to implement the prepayment incentives refers only to the amount of *additional* budget authority that the Congress would have to appropriate to preserve the project for low-income housing. These new appropriations would be needed both to provide new Section 8 aid for tenants not now receiving it and to increase that aid for current recipients. New appropriations would not be needed, however, to continue the existing Section 236 mortgage subsidy or to continue the existing level of Section 8 aid to current recipients; appropriations were made for these purposes some time ago.[21] Thus budget authority does not reflect the total costs of preservation incentives. At the same time, however, current procedures for calculating budget authority for new Section 8 aid are shown below to substantially overestimate the amount needed to cover outlays for five years, particularly for higher-income tenants (see also Appendix B).

In contrast, the amount of budget authority needed to provide vouchers to replace assisted units lost when a mortgage was prepaid refers to the *gross* amount of new budget authority that the Congress would have to appropriate to provide that

20. For projects in the Section 221(d)(3) Below Market Interest Rate program, current outlays do not reflect the total actual costs because the mortgage subsidies were incurred when the project was developed.

21. Budget authority to renew (at the old rent levels) Section 8 aid for current recipients that expires during the five-year period is also not counted as part of the additional budget authority needed for prepayment incentives because it would be accounted for in a different part of the housing budget.

form of aid for five years. In particular, it does not account for the fact that previously appropriated budget authority for mortgage subsidies and ongoing Section 8 aid, which no longer would be needed and would be recaptured, could, at the discretion of the Congress, be used to reduce the amount of new budget authority required for the vouchers.[22]

Thus, new budget authority is a misleading measure of total federal resources needed to carry out either option and is an inappropriate basis for comparing the cost of preservation with that of vouchers. Even so, because the Budget Enforcement Act limits both outlays and budget authority, either measure can dictate a constraint on allowable federal spending. This memorandum therefore presents the costs of prepayment incentives and vouchers in terms of both budget authority and outlays.

A Comparison of New Budget Authority and Outlays per Unit for Preservation Incentives and Vouchers

Comparing preservation incentives and vouchers is further complicated because a different group of families would probably be assisted if a project were preserved than if it dropped out of the program and vouchers were issued to replace lost assistance commitments. For example, if a project with 100 units and the tenant

22. Accounting for future savings in budget authority from not having to renew expiring Section 8 aid for current recipients after a project's mortgage had been prepaid would further reduce the amount of new budget authority actually required for vouchers.

profile shown in Table 2 were preserved, current tenants in 88 to 100 of these units would receive federal subsidies, depending on the level of preservation rent.

If the project were lost, however, the intent of the statute appears to be that vouchers would be issued to replace all units currently occupied by tenants with income not exceeding 80 percent of the area median--that is, only those occupied by tenants who would be eligible for housing aid if they applied today. For a 100-unit project with the tenant profile shown in Table 2, for example, new budget authority would be provided to replace assistance for only 94 units. Even so, however, tenants in six of these 94 units--those with income between 68 percent and 80 percent of the area median--would not be helped by the vouchers because 30 percent of their income equals or exceeds the FMR, which is the upper limit on rents subsidized with vouchers. Thus, current tenants of only 88 units would actually receive vouchers, and tenants in the remaining 12 units--those with relatively high income--would lose any aid they might have received if the project had been preserved. This analysis assumes that the budget authority that remained after assisting the 88 current tenants would be used to provide vouchers to currently unassisted families whose income does not exceed 50 percent of the area median--the target group for housing aid. (See Appendix B for a further discussion of this assumption and others that were made for this analysis.)

Budget Authority. Whether preservation incentives cost more or less than a voucher in terms of budget authority depends on whether the tenant in question already receives Section 8 aid and on the level of the preservation rent of the unit that

would be preserved. For current recipients of Section 8 aid, preservation incentives would cost less in new budget authority over a five-year period than would vouchers for five years under all three rent scenarios considered in this analysis (see Table 5). In 1991, the five-year budget authority for preservation incentives for tenants already receiving Section 8 aid would have ranged from $17,200 per unit in the first scenario to $4,700 per unit in the third scenario, compared with $26,500 for a voucher for five years in all three scenarios.

For tenants who are not currently receiving Section 8 aid but are eligible to do so, the relative amounts of budget authority needed for preservation incentives and for vouchers depend on the level of the preservation rent and the tenants' income level. For tenants with income above 50 percent of the area median, vouchers would be cheaper than preservation incentives for all tenants under the first and second scenarios; under the third scenario, they would be cheaper for all tenants except those with income between 60 percent and 67 percent of the area median. These tenants would require no budget authority at all under the preservation incentives because 30 percent of their adjusted income exceeds the preservation rent. For residents with income below 50 percent of the area median, budget authority for preservation incentives would exceed that for vouchers under the first two scenarios and would be slightly less under the third.

Outlays. In terms of outlays, vouchers are cheaper than preservation incentives for families in all income categories under the first two scenarios considered here

TABLE 5. ILLUSTRATIVE COMPARISON OF NEW BUDGET AUTHORITY PER UNIT FOR PRESERVATION INCENTIVES AND VOUCHERS FOR FIVE YEARS, UNDER ALTERNATIVE ASSUMPTIONS ABOUT THE LEVEL OF PRESERVATION RENT (In dollars)

Gross Income Relative to Area Median	Budget Authority per Unit for Five Years	
	Preservation Incentives[a]	Vouchers[b]
Scenario One: Preservation Rent Equals 120 Percent of the FMR		
Current Tenants		
Less than 50 percent[c]		
With Section 8	17,200	26,500
Without Section 8	35,700	26,500
50 percent to 59 percent[d]	35,700	12,500
60 percent to 67 percent[e]	35,700	7,900
68 percent to 80 percent[f]	35,700	0
Greater than 80 percent[g]	0	0
Newly Assisted Families (Up to 50 Percent)	n.a.	26,500
Scenario Two: Preservation Rent Equals the FMR		
Current Tenants		
Less Than 50 percent[c]		
With Section 8	10,000	26,500
Without Section 8	29,800	26,500
50 percent to 59 percent[d]	29,800	12,500
60 percent to 67 percent[e]	29,800	7,900
68 percent to 80 percent[f]	0	0
Greater than 80 percent[g]	0	0
Newly Assisted Families (Up to 50 Percent)	n.a.	26,500

(Continued)

TABLE 5. (Continued)

Gross Income Relative to Area Median	Budget Authority per Unit for Five Years	
	Preservation Incentives[a]	Vouchers[b]
Scenario Three: Preservation Rent Equals 85 Percent of the FMR[h]		
Current Tenants		
Less than 50 percent[c]		
With Section 8	4,700	26,500
Without Section 8	25,400	26,500
50 percent to 59 percent[d]	25,400	12,500
60 percent to 67 percent[e]	0	7,900
68 percent to 80 percent[f]	0	0
Greater than 80 percent[g]	0	0
Newly Assisted Families (Up to 50 Percent)	n.a.	26,500

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTES: Figures are calculated for incentives and vouchers provided in 1991. To simplify the analysis, all estimates assume a zero percent vacancy rate.

See Appendix B for procedures used to calculate budget authority and other technical assumptions.

Preservation rent = rent received by owner; LIHPRHA = Low-Income Housing Preservation and Resident Homeownership Act; FMR = fair market rent; n.a. = not applicable.

a. Excludes administrative costs incurred by HUD.
b. Includes administrative costs incurred by public housing agencies. Average budget authority per voucher is calculated for families with income equal to 25 percent of the area median.
c. For these tenants, 30 percent of their adjusted income is less than the Federal Housing Administration's (FHA's) controlled rent. Without LIHPRHA incentives, those with Section 8 aid pay 30 percent of their adjusted income and those without it pay the higher FHA-controlled rent.
d. Tenants pay 30 percent of their adjusted income, which equals or exceeds the FHA-controlled rent but is less than the fair market rental charge (FHA-controlled rent plus mortgage subsidy).
e. Without LIHPRHA incentives, these tenants pay the fair market rental charge, which is less than or equal to 30 percent of their adjusted income and less than the local Section 8 existing-housing fair market rent.
f. Tenants could pay the local Section 8 existing-housing fair market rent with 30 percent or less of their adjusted income.
g. Tenants would be ineligible for Section 8 aid and most other housing aid if they applied today.
h. This rent level is roughly equivalent to the FMR minus the mortgage subsidy.

(see Table 6). Note, however, that for families who would receive new Section 8 aid, these differences in outlays are generally smaller than the differences in budget authority shown in Table 5. This outcome reflects the overestimate of budget authority needed to cover outlays for new Section 8 aid. Only when preservation rents equal about 85 percent of the FMR--the third scenario--do preservation incentives have a cost advantage.[23]

As discussed above, if the project is not preserved for low-income housing, the 12 tenants with income exceeding 68 percent of the area median would not be helped by vouchers because 30 percent of their income equals or exceeds the upper limit on rents subsidized by vouchers. If the project is preserved, however, these tenants also would not receive any federal subsidy in the third scenario but would receive some subsidy in the other two. In particular, they would receive mortgage subsidies but no Section 8 aid in the second scenario, and six of them would receive both Section 8 aid and mortgage subsidies in the first scenario.

Comparing the Budgetary Implications of Preserving a Typical Section 236 Project and Issuing Vouchers

By combining the above results on per-unit costs with the distribution of tenants in a typical Section 236 project shown in Table 2, the total cost of preserving a typical

23. Even then, much of the difference for most tenants results from the inclusion of the public housing agencies' administrative fees in the cost of vouchers. Without that component, the outlays associated with both approaches would not differ much.

TABLE 6. ILLUSTRATIVE COMPARISON OF OUTLAYS PER UNIT FOR PRESERVATION INCENTIVES AND VOUCHERS FOR FIVE YEARS, UNDER ALTERNATIVE ASSUMPTIONS ABOUT THE LEVEL OF PRESERVATION RENT (In dollars)

Gross Income Relative to Area Median	Outlays per Unit for Five Years			
	Preservation Incentives[a]			
	From New Budget Authority	From Old Budget Authority	Total	Vouchers[b]
Scenario One: Preservation Rent Equals 120 Percent of the FMR				
Current Tenants				
Less than 50 percent[c]				
With Section 8	17,200	19,000	36,200	26,500
Without Section 8	31,700	4,500	36,200	26,500
50 percent to 59 percent[d]	16,600	4,500	21,200	12,500
60 Percent to 67 percent[e]	12,000	4,500	16,500	7,900
68 Percent to 80 percent[f]	6,400	4,500	10,900	0
Greater than 80 percent[g]	0	4,500	4,500	0
Newly Assisted Families (Up to 50 Percent)	n.a.	n.a.	n.a.	26,500
Scenario Two: Preservation Rent Equals the FMR				
Current Tenants				
Less Than 50 percent[c]				
With Section 8	10,000	19,000	29,000	26,500
Without Section 8	24,400	4,500	28,900	26,500
50 percent to 59 percent[d]	9,400	4,500	13,900	12,500
60 percent to 67 percent[e]	4,700	4,500	9,300	7,900
68 percent to 80 percent[f]	0	4,500	4,500	0
Greater than 80 percent[g]	0	4,500	4,500	0
Newly Assisted Families (Up to 50 Percent)	n.a.	n.a.	n.a	26,500

(Continued)

TABLE 6. (Continued)

Gross Income Relative to Area Median	Outlays per Unit for Five Years: Preservation Incentives[a] From New Budget Authority	From Old Budget Authority	Total	Vouchers[b]
Scenario Three: Preservation Rent Equals 85 Percent of the FMR[h]				
Current Tenants				
Less than 50 percent[c]				
With Section 8	4,700	19,000	23,700	26,500
Without Section 8	19,200	4,500	23,700	26,500
50 percent to 59 percent[d]	4,100	4,500	8,700	12,500
60 percent to 67 percent[e]	0	2,100	2,100	7,900
68 percent to 80 percent[f]	0	0	0	0
Greater than 80 percent[g]	0	0	0	0
Newly Assisted Families (Up to 50 Percent)	n.a.	n.a.	n.a.	26,500

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTES: Figures are calculated for incentives and vouchers first provided in 1991. To simplify the analysis, all estimates assume a zero percent vacancy rate. Estimates for outlays assume annual rent adjustments of 5 percent and annual increases in adjusted income of 2.5 percent.

See Appendix B for procedures used to calculate outlays and other technical assumptions.

Preservation rent = rent received by owner; LIHPRHA = Low-Income Housing Preservation and Resident Homeownership Act; FMR = fair market rent; n.a. = not applicable.

a. Excludes administrative costs incurred by HUD.
b. Includes administrative costs incurred by public housing agencies.
c. For these tenants, 30 percent of their adjusted income is less than the Federal Housing Administration's (FHA's) controlled rent. Without LIHPRHA incentives, those with Section 8 aid pay 30 percent of their adjusted income and those without it pay the higher FHA-controlled rent.
d. Tenants pay 30 percent of their adjusted income, which equals or exceeds the FHA-controlled rent but is less than the fair market rental charge (FHA-controlled rent plus mortgage subsidy).
e. Without LIHPRHA incentives, these tenants pay the fair market rental charge, which is less than or equal to 30 percent of their adjusted income and less than the local Section 8 existing-housing fair market rent.
f. Tenants could pay the local Section 8 existing-housing fair market rent with 30 percent or less of their adjusted income.
g. Tenants would be ineligible for Section 8 aid and most other housing aid if they applied today.
h. This rent level is roughly equivalent to the FMR minus the mortgage subsidy.

project can be compared with that of allowing prepayment and providing vouchers to replace certain lost assistance commitments.

Budget Authority. Preserving a typical project with 100 units for five years would require $1.1 million to $2.5 million in new budget authority under the three rent scenarios (see Table 7). This budget authority would provide new or increased assistance to 94 tenants in the first scenario, 88 in the second scenario, and 82 in the third scenario.

Issuing vouchers to replace lost commitments for the 94 units occupied by tenants with income not exceeding 80 percent of the area median would require $2.5 million in budget authority in all three scenarios. This figure assumes that the average budget authority per unit is $26,500--the amount provided for the typical voucher recipient (see Appendix B). About $0.4 million of the $2.5 million in budget authority would not be spent on current tenants, however, because some of them have relatively high income. Under existing voucher regulations, this remaining budget authority could be used to fund about 16 additional vouchers for currently unassisted families. Thus, the budget authority for vouchers would be sufficient to assist a total of 104 families: the 88 current tenants with income below 68 percent of the area median, and 16 newly assisted families with income not exceeding 50 percent of the area median.[24]

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24. The $2.5 million in budget authority for vouchers could be offset by up to $1.8 million in budget authority that would be recaptured from the remaining 20 years of unused Section 236 mortgage subsidies plus an additional amount from Section 8 aid that would no longer be used.

TABLE 7. ILLUSTRATIVE IMPLICATIONS OF PRESERVING A TYPICAL SECTION 236 PROJECT OR ISSUING VOUCHERS

	New Budget Authority (Millions of dollars)	Outlays (Millions of dollars)	Number of Assisted Tenants
Scenario One: Preservation Rent Equals 120 Percent of the FMR			
Preservation Incentives[a]	2.5	3.0	100
Vouchers[b]			
Current tenants	2.1	2.1	88
Newly assisted families	0.4	0.4	16
Total	2.5	2.5	104
Scenario Two: Preservation Rent Equals the FMR			
Preservation Incentives[a]	1.7	2.3	100
Vouchers[b]			
Current residents	2.1	2.1	88
Newly assisted families	0.4	0.4	16
Total	2.5	2.5	104
Scenario Three: Preservation Rents Equals 85 Percent of the FMR[c]			
Preservation Incentives[a]	1.1	1.8	88
Vouchers[b]			
Current tenants	2.1	2.1	88
Newly assisted families	0.4	0.4	16
Total	2.5	2.5	104

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTES: Preservation rent = rent received by owner.

Figures are calculated for incentives and vouchers first provided in 1991. To simplify the analysis, all estimates assume a zero percent vacancy rate. Estimates for outlays assume annual rent adjustments of 5 percent and annual increases in adjusted income of 2.5 percent.

See Appendix B for procedures used to calculate budget authority and outlays and for other technical assumptions.

a. Excludes administrative costs incurred by HUD. Total costs for a project with 100 units are calculated by weighting the per-unit costs in each income category (shown in Tables 5 and 6) by the percentage of units in that income category (shown in Table 2).

b. Includes administrative costs incurred by public housing agencies. Average budget authority per voucher is calculated for the typical voucher recipient whose income equals 25 percent of the area median. Total budget authority is calculated by multiplying the average budget authority by 94, the number of units currently occupied by tenants whose income does not exceed 80 percent of the area median (as specified by the statute). Because of the relatively high income of some current tenants, this total budget authority can serve the 88 tenants with income below 68 percent of the area median plus 16 new families with income below 50 percent of the area median.

c. This rent level is roughly equivalent to the fair market rent (FMR) minus the mortgage subsidy.

As discussed earlier, although these estimates of new budget authority are relevant for appropriation decisions and although they would help determine whether the discretionary budget authority caps in the BEA were met, they do not represent the true costs of these alternatives. In particular, preservation incentives for a typical project appear to be relatively cheap (despite the overestimate of budget authority for new Section 8 aid) because, for almost one-half of the units, only part of the costs would be reflected as new budget authority for these incentives.[25]

Outlays. The estimated total outlays for preserving a project with 100 units for five years range from $1.8 million to $3.0 million under the three scenarios (see Table 7). About $1.1 million of these totals would flow from existing budget authority for mortgage subsidies and ongoing Section 8 aid, and between $0.7 million and $1.8 million from budget authority newly appropriated for preservation incentives. If preservation incentives were not provided and the project's mortgage was prepaid, estimated outlays over five years would be $2.1 million for the 88 vouchers used by current tenants and $0.4 million for the 16 newly assisted families, for a total of $2.5 million in all three scenarios.

Viewed another way, if projects with relatively high preservation rents were not preserved and outlays that would have been incurred for their preservation were

25. Part of the remaining costs consists of budget authority to renew (at the former rent level) Section 8 aid that expires over the five-year period. Under current budgetary accounting procedures, that budget authority would appear elsewhere in the budget as an appropriation to renew expiring Section 8 aid.

redirected to vouchers, the total number of very-low-income families receiving assistance could be increased. For example, the $3 million in outlays for preserving a project with a preservation rent at 120 percent of the FMR could pay the $2.1 million for 88 vouchers for those tenants who would benefit from them, and the remaining $0.9 million could pay for an additional 35 vouchers to unassisted, very-low-income families. Similarly, the $2.3 million in outlays for preserving a project with a preservation rent at 100 percent of the FMR could pay for those same 88 tenants plus an additional nine unassisted, very-low-income families. Thus, instead of subsidizing the 12 tenants with the highest income under the preservation incentives, nine to 35 unassisted families with very low income could be served.

POLICY ALTERNATIVES

Given the sensitivity of the cost of prepayment incentives to the level of the preservation rent, two broad approaches could be considered. The incentives could be fully funded, as specified in current law; or incentives could be funded only for projects with relatively low preservation rents, with vouchers replacing certain lost units. The savings in federal outlays that would result from the second approach could be used to aid additional very-low-income families or for other purposes.

The possible costs of these approaches are difficult to estimate, however, mostly because of a lack of reliable data on the likely levels of preservation rents in the affected projects and the difficulty of predicting the ultimate outcome for specific

projects. Although HUD has developed rough estimates of the new budget authority that would be required for two specific approaches (see Appendix C), estimates are not now available for the more meaningful outlay totals. Nonetheless, the remainder of this memorandum assesses the qualitative impacts of the alternatives facing the Congress.

Attempt to Preserve All Units, as Envisioned in LIHPRHA

Fully funding the prepayment provisions would fulfill the intent of Congress as expressed in LIHPRHA. Dwellings built with federal subsidies to serve low-income families would be preserved for that purpose to the fullest extent possible. Preventing the loss of this housing resource could be especially important because recent reductions in federal housing assistance and changes in tax benefits passed in the Tax Reform Act of 1986 have slowed construction of additional low-rent housing. Fully funding the prepayment provisions would also minimize the involuntary displacement of current tenants, some of whom might have difficulty using their vouchers, particularly if they lived in areas with low vacancy rates in the types of dwellings that they need.

Fully funding the prepayment provisions would not target scarce resources solely toward those most in need of aid, however. Many families who would benefit from LIHPRHA subsidies, which could be quite large in the more expensive projects, have a higher income than do many very-low-income families who do not

receive housing aid. Also, in projects with relatively high preservation rents, tenants ineligible for housing aid if they applied today would nevertheless benefit from relatively low rents because of the mortgage subsidies and the FMR caps on their rent payments. These relatively low rents would enable them to pay a lower share of income for rent than do many families with similar income living in comparable unassisted housing and many families with lower income who receive housing assistance.

Fund Preservation Incentives Only for Less Expensive Projects

Alternatively, substantial savings in outlays could be achieved by allowing owners of projects with relatively high preservation rents to prepay their mortgage and by providing vouchers to replace lost assistance commitments. These savings could be used to provide vouchers to additional unassisted families with very low income or for other purposes.

One way to limit preservation incentives would be to reduce the federal cost limit to 100 percent of the FMR and to allow owners of units with higher preservation rents either to leave the program or to stay and receive only the lower rent. Alternatively, to account for the mortgage subsidy that benefits most of the affected projects, the federal cost limit could serve to restrict not the preservation rent (as it does under the current statute) but the total subsidized rent--that is, the preservation rent plus the mortgage subsidy. If the cost limit were simultaneously

reduced to the FMR, such a policy would imply for Section 236 projects that preservation rents generally could not exceed 85 percent of the FMR. It would also mean that few projects would be likely to receive any preservation incentives; most affected projects with rents below that level would have no prepayment potential because of relatively low alternative market rents.

As discussed above, the savings in outlays from these approaches would not necessarily be reflected in corresponding savings in new budget authority. For example, as implied by Table 7, preserving projects with rents at or somewhat above 100 percent of the FMR would require less new budget authority--but would generate higher outlays--than issuing vouchers for the 88 current tenants of the projects. Thus, in any given year, carrying out such an option might actually *increase* total new budget authority requirements if a large share of the units have preservation rents in this range. Although the budget authority recaptured from unused mortgage subsidies and Section 8 aid could be used to help offset budget authority needed to provide vouchers, substantial amounts of net new budget authority could still be associated with such an approach.

Limiting the use of prepayment incentives and expanding the use of vouchers would reduce the unequal treatment of households in similar economic circumstances by increasing the number of assisted families and thus expanding somewhat the share of eligible families receiving aid. It would also reduce or eliminate the differential treatment between current voucher recipients and tenants in these projects. Voucher recipients who wish to live in units with rents exceeding

the FMR (which probably have greater amenities or are in a better location than those with lower rents) must pay that difference out of pocket, in addition to paying 30 percent of their income for rent. Under these alternatives, current tenants in projects allowed to leave the program could choose to use their voucher to stay there. Like any voucher recipient, however, they would then also have to absorb any difference between the unit's new rent and the FMR rather than have the government pay it, as would occur under the preservation incentives. Finally, limiting the use of prepayment incentives would improve the targeting of scarce resources by eliminating the need to provide subsidies to some current tenants who can afford to pay the FMR but not the high preservation rent.

A decision not to fund the preservation of a project solely because doing so costs more than vouchers would not, however, account for potential problems faced by current tenants, such as low local vacancy rates in affordable housing or the noneconomic costs incurred by families who are involuntarily displaced. Some projects with preservation rents that are high relative to the local FMRs may be in areas with low vacancy rates in standard units of the same size renting at or below the FMR. In those cases, families (with or without vouchers) displaced from these projects might have trouble finding alternative housing unless they paid more than 30 percent of their income for rent. For three years after the mortgage has been prepaid, however, LIHPRHA does protect current tenants in low-vacancy areas and all tenants with special needs from being displaced.

APPENDIX A

SUPPLEMENTARY TABLES

This appendix presents tables containing the data used in constructing the figures that appear in the text of the memorandum.

TABLE A-1. TRENDS IN HOUSING AID ADMINISTERED BY HUD, 1977-1992

Fiscal Year	Number of Assisted Families (Thousands)	Outlays (Millions of 1992 dollars)	Budget Authority (Millions of 1992 dollars) Total	Incremental	Other Nonincremental	Amendments and Renewals
1977	2,643	6,586	65,672	61,440	4,145	87
1978	2,842	7,592	63,531	58,028	5,423	81
1979	3,032	8,128	61,723	58,303	3,344	77
1980	3,105	9,368	47,691	40,488	7,146	56
1981	3,297	10,676	45,695	36,230	8,584	881
1982	3,508	11,635	26,764	16,732	9,617	416
1983	3,727	13,331	19,855	9,450	9,903	502
1984	3,868	14,934	18,911	11,481	7,113	317
1985	3,943	32,815 [a]	15,629	9,786	5,415	428
1986	4,077	15,566	14,301	9,216	4,025	1,061
1987	4,151	15,534	11,535	6,397	4,135	1,003
1988	4,227	16,324	11,718	5,932	4,685	1,101
1989	4,315	16,470	9,841	4,375	4,088	1,378
1990	4,386	17,018	11,201	3,732	4,897	2,571
1991	4,432	17,438	17,933	3,153	5,483	9,296
1992 [b]	4,578	18,559	24,000	7,172	6,677	10,151

SOURCE: Congressional Budget Office tabulations of budget documents of the Department of Housing and Urban Development, various years.

NOTE: HUD = Department of Housing and Urban Development.

a. The bulge in outlays in 1985 resulted from a change in the method of financing public housing, which generated nearly $14 billion in one-time expenditures. Because of those expenditures, outlays for public housing since that time have been roughly $1.4 billion (in nominal dollars) less each year than they would have been otherwise.

b. Figures for 1992 are estimated.

TABLE A-2. DISTRIBUTION OF PREPAYMENT-ELIGIBLE UNITS BY ESTIMATED PRESERVATION RENT AS A PERCENTAGE OF FAIR MARKET RENT

Preservation Rent as a Percentage of Section 8 FMR	Number of Units	Units as a Percentage of Total
Less than 85 Percent[a]	136,258	41
85 Percent to 100 Percent	111,440	34
101 Percent to 120 Percent	56,643	17
Greater than 120 Percent		
Within federal cost limit[b]	18,802	6
Above federal cost limit[c]	7,048	2
Subtotal	25,850	8
Total	330,191	100

SOURCE: Congressional Budget Office calculations based on estimates provided by the Department of Housing and Urban Development.

NOTES: Preservation rent = rent received by owner.

The table excludes 26,645 units estimated by HUD to convert to home ownership.

These estimates should be considered with great caution because of the uncertainty regarding the actual preservation rents of these projects. These rents cannot be determined accurately until the projects are appraised. Thus, the actual distribution may differ considerably from that shown here.

a. HUD estimates that most of these units currently have no prepayment potential because alternative market rents are relatively low.

b. The effective federal cost limit for these units is 120 percent of the prevailing rents in the neighborhood rather than 120 percent of the local Section 8 existing-housing fair market rent.

c. HUD estimates that prepayment will take place for these units because their preservation rents exceed both 120 percent of the prevailing rents in the neighborhood and 120 percent of the local Section 8 existing-housing fair market rent.

TABLE A-3. SOURCES AND RECIPIENTS OF ANNUAL RENT PAYMENTS IN A TYPICAL SECTION 236 PROJECT AFTER IMPLEMENTATION OF PRESERVATION INCENTIVES

		Sources of Annual Rent Payments			Recipients of Annual Rent Payments		
			Federal Subsidy				
	Total Subsidized Rents	Tenant Rent Payments	Section 8	Section 236	Project Owners	Mortgage Lenders	Flexible Subsidy Fund
Scenario One: Preservation Rent Equals 120 Percent of the FMR[a]							
Less Than 50 Percent							
With Section 8	8,504	2,198	5,399	907	7,597	907	0
Without Section 8	8,504	2,198	5,399	907	7,597	907	0
50 Percent to 59 Percent	8,504	4,990	2,607	907	7,597	907	0
60 Percent to 67 Percent	8,504	5,854	1,743	907	7,597	907	0
68 Percent to 80 Percent	8,504	6,264	1,333	907	7,597	907	0
Greater Than 80 Percent	7,171	6,264	0	907	6,264	907	0
Per-unit average	8,424	3,240	4,277	907	7,517	907	0
Scenario Two: Preservation Rent Equals the FMR							
Less Than 50 Percent							
With Section 8	7,171	2,198	4,066	907	6,264	907	0
Without Section 8	7,171	2,198	4,066	907	6,264	907	0
50 Percent to 59 Percent	7,171	4,990	1,274	907	6,264	907	0
60 Percent to 67 Percent	7,171	5,854	410	907	6,264	907	0
68 Percent to 80 Percent	7,171	6,264	0	907	6,264	907	0
Greater Than 80 Percent	7,171	6,264	0	907	6,264	907	0
Per-unit average	7,171	3,240	3,024	907	6,264	907	0
Scenario Three: Preservation Rent Equals 85 Percent of the FMR[b]							
Less Than 50 Percent							
With Section 8	6,264	2,198	3,159	907	5,357	907	0
Without Section 8	6,264	2,198	3,159	907	5,357	907	0
50 Percent to 59 Percent	6,264	4,990	367	907	5,357	907	0
60 Percent to 67 Percent	6,264	5,854	0	907	5,357	907	497
68 Percent to 80 Percent	6,264	6,264	0	907	5,357	907	907
Greater Than 80 Percent	6,264	6,264	0	907	5,357	907	907
Per-unit average	6,264	3,240	2,255	907	5,357	907	139

SOURCE: Illustrative calculations by the Congressional Budget Office based on unpublished data from the Department of Housing and Urban Development.

NOTE: Preservation rent = rent received by owner.

a. Section 8 subsidies shown in this scenario are somewhat higher than those shown in tables in the text. This increase illustrates likely adjustments made by the government to prevent shortfalls in rental income received by project owners. Without this adjustment in Section 8, the owner would receive less than the preservation rent because rents received from tenants in the highest income group are capped by the fair market rent (FMR) and because program rules do not allow direct Section 8 aid to be paid on behalf of these tenants.

b. This rent level is roughly equivalent to the FMR minus the mortgage subsidy.

APPENDIX B

TECHNICAL ISSUES IN COMPARING THE COSTS OF PREPAYMENT PROVISIONS AND VOUCHERS

During the course of the analysis presented in this memorandum, a number of technical issues arose that also need to be resolved when estimating the annual costs of the prepayment provisions for budgetary purposes. Most of these issues were resolved in ways consistent with the methodology implicit in HUD's cost estimates of LIHPRHA.

First, how should budget authority for project-based Section 8 aid be calculated? Under standard procedures used by HUD and the Congressional Budget Office (CBO), budget authority for all types of new Section 8 aid is calculated by multiplying 95 percent of the first year's full rent by the term of the aid, currently five years. Implicit in this standard procedure is the assumption that inflation in rents--and thus subsidies--over the term of the contract is covered by annual reserves created from tenants' contributions toward rent. For Section 8 aid tied to these Section 236 projects, however, this procedure tends to overestimate budget authority relative to projected five-year expenditures because the income of a sizable proportion of tenants in Section 236 projects is higher than that of the average Section 8 recipient. Thus, the current procedure may need to be changed to reflect more accurately the projected five-year expenditures. This analysis, however, used standard budgetary procedures for estimating five-year budget authority for Section 8 aid.

By contrast, the calculation of the subsidy component of budget authority for vouchers is mandated by statute. It is derived by multiplying 115 percent of the first year's estimated subsidy (the difference between the FMR and 30 percent of a tenant's income) by five (the term of the assistance). The 115 percent factor is an allowance for inflation. To this amount is added budget authority for administrative fees, which consist of estimated annual fees for five years, at 8.2 percent of the FMR for a two-bedroom unit, plus a one-time fixed fee of up to $275.

Second, if a given project's mortgage was prepaid, how many vouchers would be issued? Would vouchers be issued to replace

- All units in order to maintain in a locality the same number of assisted units potentially available for low-income families (defined by statute as those with income not exceeding 80 percent of the area median) even if some units in the project are not currently occupied by such tenants?

- Only the approximately 94 percent of units occupied by low-income tenants? (Although defined as low-income, about 6 percent of all tenants--those with income between 68 percent and 80 percent of the area median--would not benefit from vouchers because they can pay the FMR with 30 percent or less of their income.)

- Or only the 88 percent of all units occupied by tenants who could actually benefit from vouchers?[26]

This analysis assumed that the policy objective is to maintain the number of assisted slots currently held by low-income tenants. Thus, the number of vouchers issued in cases of prepayment would equal the number of units currently occupied by low-income tenants. Vouchers issued on behalf of current tenants who can pay the FMR with 30 percent of their adjusted income (and who therefore do not benefit from vouchers) are assumed to be provided to unassisted families with income not exceeding 50 percent of the area median. Under these assumptions, those slots vacated by families with income above 80 percent of the area median would be lost.

Third, what level of income should be reflected in the budget authority allotted to public housing agencies (PHAs), which administer the voucher program? Should it be the income levels of the tenants in the project that leaves the assisted inventory or should it be the income level of the typical applicant for vouchers in the area, whose income may not exceed 50 percent of the area median? Once PHAs receive an allotment of budget authority for vouchers, they control the number of vouchers issued. The ultimate number would decrease, for example, as the size (and thus the rent) of the units needed by the recipients increased or their income levels decreased. If the budget authority allocation reflected the income levels of current

26. The statute is ambiguous on this issue. Section 223(a) requires that Section 8 rental assistance be provided for displaced low-income tenants--those with income at or below 80 percent of the area median. Section 223(e) states, however, that "The Secretary shall allocate assistance ... so that the total number of assisted units in each [HUD] region available for occupancy by, and affordable to, lower income families ... does not decrease because of prepayment."

tenants and some of the higher-income tenants did not use their vouchers, a PHA would have insufficient funds to provide those vouchers to currently unassisted families eligible for vouchers. Thus, this analysis assumes that the budget authority per voucher would be sufficient to assist a typical very-low-income family, one with income at 25 percent of the area median and with 2.5 persons.

Fourth, how should the cost of administration be treated when comparing preservation incentives with vouchers? Because the LIHPRHA provisions are so complex, the administrative costs incurred by HUD could be substantial. However, they are not explicitly included in appropriations for the housing budget. The costs of vouchers, on the other hand, do include fees to PHAs for administering them, but not the administrative costs incurred by HUD. Thus, other things equal, vouchers could appear to be somewhat more expensive, even if they were actually cheaper. For this analysis, CBO included the administrative fee in the cost estimates for vouchers and made no attempt to estimate the administrative costs of the preservation incentives.

Finally, in cases of prepayment, would budget authority recaptured from mortgage subsidies in Section 236 projects and any ongoing Section 8 aid be used to offset the budget authority needed for vouchers? If so, recaptured budget authority associated with the remaining 20 years of mortgage subsidies would be used to offset budget authority for five-year vouchers. Thus, vouchers would appear unduly cheap when they were first issued and much more expensive when renewed

every five years. In this analysis, for illustrative purposes, any recaptured budget authority does not offset the amount of budget authority needed for vouchers.

APPENDIX C

ESTIMATED BUDGET AUTHORITY FOR PREPAYMENT PROVISIONS AND SOME PROBLEMS ASSOCIATED WITH THOSE ESTIMATES

The Department of Housing and Urban Development estimates that fully funding the preservation provisions in LIHPRHA would require $1.05 billion in new budget authority in 1993 and a total of $5.15 billion over the 1993-1997 period (see Table C-1). Of this total, $5 billion would provide preservation incentives to 173,000 units, and $140 million would fund 6,000 five-year vouchers to replace units expected to be lost in spite of the available incentives. The $5 billion for preservation incentives includes $950 million in budget authority to renew, in 1996 and 1997, expiring preservation aid originally funded for five years from 1991 and 1992 appropriations, some of which was for projects assisted under the Emergency Low Income Housing Preservation Act of 1987.

As pointed out in the introduction, providing incentives for all projects eligible for prepayment would probably reduce resources available for incremental aid. If total housing aid (except for renewals of expiring Section 8 aid) was funded roughly at the 1992 appropriation (adjusted for inflation), if nonincremental aid was funded at the same level received in 1992 (adjusted for inflation), and if the prepayment provisions were funded at the expense of incremental aid, then budget authority for incremental aid might fall to $2.7 billion in 1993 and $1.3 billion in 1994.

TABLE C-1. ESTIMATED BUDGET AUTHORITY FOR INCREMENTAL AID AND PREPAYMENT PROVISIONS, UNDER ALTERNATIVE POLICIES, 1993-1997 (In millions of nominal dollars)

Budget Authority	1993	1994	1995	1996	1997	Total 1993-1997
			Fully Fund Prepayment Provisions According to Current Law			
Incremental Aid	2,650	1,350	3,600	3,750	3,300	14,650
Prepayment Provisions						
Incentives	1,000	2,450	350	350	900	5,000
Vouchers	50	20	10	10	40	140
Subtotal	1,050	2,450	350	350	950	5,150
Total	3,700	3,800	3,950	4,100	4,200	19,750
			Reduce Federal Cost Limit to the FMR, Allow Projects Exceeding the FMR to Prepay, and Provide Vouchers for Tenants in Those Projects			
Incremental Aid	2,550	1,350	3,600	3,800	3,550	14,850
Prepayment Provisions						
Incentives	700	2,000	250	250	650	3,850
Vouchers	450	450	80	50	30	1,050
Subtotal	1,150	2,450	350	300	700	4,950
Total	3,700	3,800	3,950	4,100	4,200	19,750

SOURCE: Congressional Budget Office estimates and estimates provided by the Department of Housing and Urban Development.

NOTES: Details may not add to totals because of rounding.

Annual budget authority for prepayment provisions does not reflect the recapture of previously appropriated budget authority from Section 236 mortgage subsidies and ongoing Section 8 aid when mortgages are prepaid and vouchers are issued; nor does it reflect savings in budget authority from not having to renew ongoing Section 8 aid. If such recaptures and savings were subtracted from the budget authority for prepayment provisions, savings from the alternative in the bottom panel would increase.

Total budget authority is based on the 1992 appropriation for all housing assistance programs, adjusted for inflation, except that renewals are assumed to be fully funded each year. Special factors in 1992 supplied a large amount of budget authority in addition to that year's appropriation, which made possible higher funding levels of both incremental and nonincremental aid. This analysis assumes that all nonincremental aid combined (other than renewals) over the 1993-1997 period is funded at the level actually received in 1992, adjusted for inflation, with incremental aid receiving the remainder.

If the federal cost limit was reduced to the FMR and all owners of units with preservation rents exceeding the FMR were allowed to prepay their mortgages, an estimated $4.9 billion in budget authority would be needed for the prepayment provisions over the 1993-1997 period (see Table C-1). As expected, and underscoring the analysis presented in this memorandum, the savings in budget authority relative to fully funding the provisions are small, mostly because of the relatively large amount of new budget authority needed to issue about 48,000 new vouchers. These estimates do not reflect either the recapture of previously appropriated budget authority from the existing mortgage subsidies and ongoing Section 8 subsidies or the savings in budget authority from not having to renew the ongoing Section 8 subsidies; thus, the estimates overstate the costs of lowering the cost limit.

As HUD points out, these figures are "order of magnitude" estimates, and the actual budget authority requirements could be significantly higher or lower. Various factors contribute to the uncertainty of these estimates. First, considerable uncertainty exists regarding the accuracy of the estimated preservation rents in the absence of formal appraisals. If actual preservation rents turn out to exceed the estimates, total preservation costs would increase, and vice versa.

Second, the number of projects that will actually be sold to buyers who agree to preserve the low-income use may be higher or lower than that assumed in HUD's estimates. As discussed earlier, federal costs incurred in transfers would typically be higher (but never less) than those incurred if the current owner retains the

project for low-income use. Thus, with more or fewer transfers, preservation costs might be higher or lower.[27]

Third, HUD's estimates of fully funding the prepayment provisions assume that owners of all projects whose preservation rents equal or exceed the federal cost limit would prepay. Under current law, however, these owners would be allowed to do so only if, despite the availability of grants to reduce the preservation rents to the federal cost limit, no buyers could be found who agreed to maintain the low-income use of the projects. Because preservation costs per unit in these projects would substantially exceed the cost of vouchers, total preservation costs would increase if the projects did not prepay. Over the 1993-1997 period, however, only 6,000 units are in this category.

Finally, under current law, if owners offer projects for sale under LIHPRHA whose preservation rents are below the federal cost limit, but purchasers who agree to maintain their low-income use cannot be found, the owners would also be allowed to prepay. Thus, the number of prepayments could be higher than the 6,000 that HUD estimated would occur under current law. The impact of this outcome on total preservation costs is indeterminate because the cost of preserving a given project could be more or less than the cost of issuing vouchers to displaced tenants.

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27. Costs considered here are limited to those incurred by the housing budget. Federal costs incurred upon the transfer of a project are partially offset, however, by receipts of taxes due upon sale.