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The Future of Enhanced Vouchers: Cost and Considerations for a City Program to Supplement Federal Section 8 Rental Assistance

Summary

The President's 2005 budget for the federal Department of Housing and Urban Development (HUD) proposes limiting the enhanced Section 8 voucher program—designed to allow income-eligible tenants of formerly subsidized buildings to remain in their homes when rents rise to market levels—to one year of benefits. Under the Bush plan, after one year, eligible households would receive a standard Section 8 voucher, which offers more limited financial assistance—and has more restrictive eligibility.

In New York City, tenants of some Mitchell-Lama and Project-Based Section 8 buildings have relied on enhanced vouchers to protect them from major rent increases when their landlords have "opted out" of the federal subsidy program or bought out their state-subsidized mortgage. Tenant advocates and representatives fear that the abrupt transition to a potentially much higher rent payment after one year could force many residents out of their current apartments. They have suggested that the city could create a rental subsidy program that would take the place of the expiring enhanced vouchers, allowing residents to stay in their homes. In this analysis, IBO assesses the potential cost of a city rent subsidy to replace expiring enhanced vouchers, as well as other program considerations.

There is not yet legislation to enact President Bush's proposal, nor is there a specific plan to create a New York City-funded replacement for the enhanced voucher program. Numerous uncertainties exist, therefore, regarding the scope and cost of any program. Cost estimates vary significantly based on program parameters, the universe of covered units, and the likelihood of future opt-outs, and range anywhere from $3,000 to $22,000 per household annually.

The incremental cost of paying the difference between a standard and enhanced Section 8 voucher for all existing enhanced voucher recipients, assuming they were all eligible for the standard Section 8 voucher, is estimated to be $27.3 million per year. Full replacement of these enhanced vouchers would cost $51.0 million annually. The incremental cost for residents of certain city-supervised Mitchell-Lama buildings with pending buyouts is estimated to be up to $36.7 million annually, while a program to replace these vouchers would be $53.0 million. Total costs would rise substantially if the program was extended to the tens of thousands of similarly situated city households.

Background
In the late 1960s through the 1970s, the federal and state governments subsidized the construction of affordable housing through a variety of programs. In exchange for low-cost loans and other subsidies, developers agreed to rent restrictions for a set period of time, ranging from 20 to 50 years. Many of these buildings have either fulfilled their contractual obligation for affordability, or owners have pre-paid their subsidized mortgages, allowing them to lift affordability restrictions. In New York City, there are two major programs where expiring subsidies and "opt outs" have become a significant issue: Project-Based Section 8 and Mitchell-Lama.

More than 65,000 units of affordable housing were built in New York City under the federal Section 8 program.[1] Unlike tenant-based Section 8, in which a household receives assistance in the form of a voucher to rent an apartment of its own choosing, under Project-Based Section 8, the subsidy is attached to a particular unit. Low income households pay 30 percent of their income in rent, and the difference between the tenant contribution and the contractual rent is paid by the federal government. Many of the original contracts began to expire in the mid 1990s, and some building owners have chosen not to renew expiring contracts, instead converting their buildings to market-rate rents. When a Project-Based Section 8 building leaves the program, tenants are generally eligible for an enhanced Section 8 voucher, which pays the difference between 30 percent of their household income and the new market rent, to allow them to stay in their homes.

Mitchell-Lama was a New York State program to provide subsidized mortgages and other benefits for the construction of middle-income housing in the 1960s and 1970s. A total of 75,000 rental units were built in New York City (another approximately 65,000 co-op units were also built). These buildings have reached the point where owners are allowed to pre-pay their subsidized mortgages, and subsequently lift affordability restrictions. Some of the Mitchell-Lama rental buildings were developed with federal Section 236 mortgage interest subsidies. If these Section 236 buildings opt out of Mitchell-Lama, income-eligible tenants are eligible for enhanced Section 8 vouchers. Tenants in buildings without Section 236 interest subsidies are not currently eligible for enhanced vouchers.

Enhanced Section 8 vouchers pay the difference between the new market-level rent and a household's subsidized rent or 30 percent of income, whichever is greater. Unlike standard Section 8 vouchers, which are primarily targeted to very low income households (incomes of no more than 50 percent of area median income (AMI)—$31,400 for a family of four), enhanced vouchers are available to households with incomes of up to 95 percent of AMI, currently $59,660 for a family of four.[2] In addition, enhanced vouchers are not subject to the ceilings on rents which apply to regular Section 8 vouchers—the enhanced vouchers cover the difference between the tenant contribution and market rent.

The President's Proposal
The President's proposed federal fiscal year 2005 budget for the Department of Housing and Urban Development calls for limiting use of an enhanced Section 8 voucher to one

year per household. After receiving an enhanced voucher for one year, eligible households would receive a standard Section 8 voucher.

Under the President's proposal, however, some households that would receive an enhanced voucher would not be eligible for a standard Section 8 voucher, and therefore would be without any federal rental assistance after one year, as discussed in more detail below. If this is the case, a city program to replace expiring enhanced vouchers would have to cover the full cost of the voucher, not just the incremental difference between a standard voucher and the expiring enhanced voucher.

Although not explicitly addressed in the President's budget proposal, it appears that the one-year limit would also apply to households already receiving enhanced vouchers, as well as to families entering the program in the future. Households that already have enhanced vouchers would be moved to the standard Section 8 program after one year, assuming they were eligible.

Considerations for a New York City Program

Tenant advocates and representatives fear that the abrupt transition to a potentially much higher rent payment after one year could force many residents out of their current apartments. They have suggested a city rental subsidy program that would either replace the enhanced voucher, or be structured to cover the incremental cost between the standard Section 8 voucher and the enhanced voucher.

Implementation Issues. President Bush's proposal requires that after receiving an enhanced voucher for a year, households receiving standard Section 8 vouchers must comply with all the rules of Section 8 program. Two provisions of the proposed program, however, could result in disqualification for a standard voucher for some households:

- Households must have incomes of no more than 80 percent of area median income (compared to 95 percent for most enhanced voucher recipients in New York City)
- Households must live in units in which the rent is "reasonable and appropriate in comparison with rents charged for dwelling units of a modest nature in the private, unassisted local market."

This first provision would exclude households earning between 80 and 95 percent of AMI from participation. These households would be ineligible for a standard Section 8 voucher, and therefore there would be no "increment" for the city to fund. In order to keep these households in their homes, the city would have to pay the full cost of the enhanced voucher.

A potentially more significant problem is the "reasonable and appropriate" rent test. In 2002 the average rent for a market-rate two-bedroom apartment in downtown Manhattan was over $4,000 per month.[3] Most former Mitchell-Lama or Project-Based Section 8 units would not command this rent—these buildings were not built to luxury standards—but even assuming a 30 percent "markdown," this would still leave a monthly rent of

$2,880. Under current Section 8 rules, the maximum two-bedroom rent for a New York City household with a voucher is $1,073. Although President Bush's proposal eliminates the HUD-established "Fair Market Rent," and gives housing authorities substantial latitude to set their own program rules, it would be prohibitively expensive for New York City Housing Authority (NYCHA) to more than double the current rent ceilings. If market rents exceed what NYCHA were to deem a "reasonable and appropriate" rent for the area, tenants would not be able to use Section 8 vouchers to stay in their old apartments. In order to receive a Section 8 voucher, tenants would have to move to lower cost apartments. In this case again, there would be no rent increment to cover through a city subsidy program.

Scope. Another critical issue for any New York City program is the universe of units that would be covered.

Currently, 3,400 city households receive enhanced vouchers. There are 1,736 households receiving enhanced vouchers as a result of Project-Based Section 8 opt outs. These vouchers are administered through the New York City Housing Authority, which is not city-funded, but NYCHA would lose funding for these vouchers if President Bush's proposal became law. The city Department of Housing Preservation and Development (HPD) currently administers another 1,688 enhanced vouchers, primarily for households in former Mitchell-Lama buildings.

IBO was originally asked to estimate the cost of replacing expiring enhanced vouchers with a city rental subsidy for residents of city-supervised Mitchell-Lama buildings occupied after December 31, 1973 with Section 236 subsidies—that is, Mitchell-Lama buildings for which the city bears some responsibility, that would not benefit from rent stabilization, and in which income-eligible tenants would normally be entitled to receive an enhanced voucher. There are about 10,829 apartments that are so situated, including 1,329 units in the Independence Plaza development, which is currently negotiating a buyout.[4]

However, a city program to replace expiring enhanced vouchers with a city rental subsidy could potentially be much more extensive if it included other households. For example, in addition to the 10,829 city-supervised units occupied after December 31, 1973 (and hence not under rent stabilization protection), another 20,690 units are in state-supervised projects.

Buildings that were occupied prior to 1974 are covered under New York's rent-stabilization laws. Tenants in the buildings, therefore, are less often in need of rental assistance after a buyout. A recent court case, however, has suggested that owners can apply for a "unique and peculiar rent increase" to cover costs associated with buyout, such as property tax payments. As a result, tenants in these buildings could be subject to a significant rent increase before rent regulation protections take effect. The case is still under appeal, but the tenants in pre-1974 buildings could face some of the same pressures as those living in developments occupied after December 31, 1973. There are 8,994 units in pre-1974 Mitchell-Lama buildings that are eligible for enhanced vouchers, and could potentially be included in a city rent subsidy program.

Buildings that would not be eligible under current rules for an enhanced Section 8 voucher include those Mitchell-Lama buildings that did not receive a federal Section 236 mortgage subsidy, or that do not also have a Project-Based Section 8 contract. There are some 15,000 units in these buildings. Although tenants would not currently qualify for an enhanced voucher, they are also predominately low-income households, facing significant rent burdens in the event of a buyout.

Eligibility of Mitchell-Lama Rental Buildings for Enhanced Section 8 Vouchers

		City	State	Total
Units Currently Eligible for Enhanced Vouchers				
Occupied after 1973				
	Current	7,833	19,796	27,629
	Pending	2,996	894	3,890
	Subtotal	10,829	20,690	31,519
Occupied before 1974				
	Current	4,879	2,792	7,671
	Pending	507	816	1,323
	Subtotal	5,386	3,608	8,994
TOTAL		**16,215**	**24,298**	**40,513**
Units Currently Not Eligible for Enhanced Vouchers				
Occupied after 1973				
	Current	1,502	1,416	2,918
	Pending	586	-	586
	Subtotal	2,088	1,416	3,504
Occupied before 1974				
	Current	7,261	4,055	11,316
	Pending	-	247	247
	Subtotal	7,261	4,302	11,563
TOTAL		**9,349**	**5,718**	**15,067**
GRAND TOTAL		**25,564**	**30,016**	**55,580**
Pending Buyouts		**4,089**	**1,957**	**6,046**

SOURCES: IBO; New York State Department of Housing and Community Renewal Annual Report on Mitchell Lama, 2003; Department of Housing and Urban Development; Office of the City Comptroller: "Affordable No More: New York City's Looming Crisis in Mitchell-Lama and Limited Dividend Housing" (2004); Department of Housing Preservation and Development.

NOTE: There are a significant number of Mitchell-Lama tenants using Section 8. Mitchell-Lama buildings may also receive Project-Based Section 8 subsidies or households may have tenant-based vouchers.

In addition to the nearly 56,000 units in Mitchell-Lama buildings, including over 6,000 in pending buyouts, there are 67,057 units that receive other project-based subsidies, primarily Project-Based Section 8**.** The majority of these are still active contracts, but 6,138 units are in projects with expired contracts that have not yet either renewed or terminated; another 2,248 units are located in Project-Based Section 8 buildings that have already opted out.

Of course, not all units will choose to opt out of the subsidy programs. Opting out typically increases an owner's expenses, because of higher mortgage and tax payments. In addition, the opt-out process can be drawn out and both politically and financially damaging if tenants choose to contest the opt-out. In some cases, it can make more sense for a building to remain in the subsidy program.

Finally, not all tenants in the above units are income eligible for enhanced vouchers, and therefore would probably not be covered in any city subsidy program. Based on the 2002 Housing and Vacancy Survey (HVS), about 79 percent of all tenants in Mitchell-Lama rental buildings have an income at or below 95 percent of AMI for their household size. Based on Section 8 requirements, all of the households currently living in Section 8 buildings should be income eligible for enhanced vouchers in the event of an opt out.

Potential Cost of a City Program
In this section we examine the potential costs of a city program designed either to pay for the increment between the standard and enhanced Section 8 voucher costs, or replace the rental subsidy provided by enhanced vouchers after the proposed one-year expiration.

Per Voucher Cost. The cost of an enhanced voucher under the existing program ranges significantly. The NYCHA-administered enhanced vouchers average $10,068 annually, and the enhanced vouchers overseen by HPD cost $19,836 on average each year. Most of the NYCHA enhanced vouchers reflect the opt-outs of Project-Based Section 8 buildings, which typically had low rents and high administrative costs when participating in the Section 8 program. Owners of Mitchell-Lama buildings, on the other hand, receive somewhat higher rents and have lower administrative burdens. As a result, it often makes financial sense for a project-based Section 8 owner to opt-out at lower market rent levels than it does for a Mitchell-Lama owner.[5]

Similarly, the cost per voucher for future buyouts will vary as a function of local market rent levels. If all Mitchell-Lama units citywide are equally likely to leave the program, IBO estimates the average cost of an enhanced voucher for these tenants to be about $10,250 per year. However, looking only at the units that are most likely to buy out—those with pending agreements or in prime real estate markets—the estimated average voucher cost rises to about $22,400 annually.

A standard Section 8 voucher in New York City costs roughly $6,900 per year.[6] The annual incremental cost of a city program to replace enhanced Section 8 vouchers could therefore be anywhere from roughly $3,000 for the lower-cost vouchers, to as much as $15,500 or more in the highest cost neighborhoods.

Incremental Program Cost. If the city's cost was limited to the difference between the standard and enhanced vouchers, and assuming all current enhanced voucher holders would be eligible for and would receive standard Section 8 vouchers, it would cost $27.3 million annually to supplement the Section 8 subsidy to the 3,400 city households that currently receive enhanced vouchers. However, as noted above, some unknown number of households currently receiving enhanced vouchers would not be eligible for standard vouchers, which would reduce the total cost.

Estimated Annual Cost to Extend Existing Vouchers

Administering agency	No. of households	Current average cost	Average cost of standard voucher	Difference	Total Cost (millions)
NYCHA	1,736	$10,068	$6,900	$3,168	$5.5
HPD	1,688	$19,836	$6,900	$12,936	$21.8
TOTAL	**3,424**				**$27.3**

SOURCE: IBO; New York City Housing Authority; Departments of Housing Preservation and Development.

There are 2,996 households in post-1973, city-sponsored, Section 236/Section 8 Mitchell-Lama buildings with pending buyouts. Assuming that 79 percent were eligible for an enhanced Section 8 voucher, the estimated annual cost to cover the increment between the standard and enhanced Section 8 vouchers is $36.7 million. To the extent that households failed to meet eligibility requirements, however—because their rents were higher than the "reasonable and appropriate" standard established by NYCHA—the cost would be less, unless the city decided to bear the full cost, as discussed below.

Replacement Program Cost. As discussed above, the President's plan could leave some households with no federal rental assistance if they are ineligible for standard Section 8 vouchers after their enhanced vouchers expire. In this case, a city program could cover the full annual cost—anywhere from $10,000 to $22,000 per household per year.

To replace the existing enhanced vouchers would cost approximately $51.0 million. To provide full rental subsidies for the income-eligible households in post-1973, city-sponsored Mitchell Lama buildings which are eligible for enhanced vouchers under current rules, and which have pending buyouts, would cost approximately another $53.0 million.

For any program—structured either to pay for incremental or total replacement costs—the total city expense would grow if the number of households was expanded to include state-sponsored units and/or those not currently eligible for enhanced vouchers.

Estimated Cost to Replace Section 8 Enhanced Vouchers for Selected Cases
Dollars in millions

	Existing Enhanced Vouchers	City-Sponsored, Post-1973 Mitchell Lama (pending buyouts)
Number of units	3,424	2,996
Incremental cost only	$27.3	$36.7
Full replacement cost	$51.0	$53.0

SOURCE: IBO.
NOTE: Incremental cost estimate assumes that 79 percent of units are eligible and city pays the difference between standard Section 8 voucher cost of $6,900 and costs of existing vouchers. For the pending buyouts column, cost of existing voucher is assumed to be $22,408 per household.

New Property Tax Revenues Could Partially Offset Program Cost

Depending on the structure of a rent subsidy program, the cost could be partially offset by increased property tax revenue.

When owners opt out of subsidy programs, they typically lose any property tax exemptions that they had been receiving as part of the assistance package. Therefore opt outs often boost the city's tax rolls. Because the buildings that are leaving the program are generally in desirable locations and are often quite large, the additional tax revenue can be substantial. For example, IBO estimates that if the pending Mitchell-Lama buyouts go through, these buildings could generate more than $16 million in additional revenue annually—somewhat less than half the estimated incremental cost.[7] On a per unit basis, the average new tax revenue would be about $3,900.

Other subsidized developments, such as Project-Based Section 8 buildings, may qualify for one of several property tax exemptions, or pay full property taxes. Like Mitchell-Lama buildings, it is unlikely that the property tax revenue generated through opt outs would be enough to cover the cost of a rental subsidy, unless the subsidy was structured to limit eligibility.

Calculating the Cost of an Enhanced Voucher Program: Methodology and Sensitivity Analysis

Methodology

The annual cost of providing rental assistance to replace expiring enhanced vouchers is calculated as follows:

Annual cost = (rent gap) × (percent eligible) ×(number of units) × 12;

where *rent gap* is the difference between market rent and the tenant's contribution; *percent eligible* represents the percentage of households with incomes below 95 percent of area median income for their family size; *number of units* is the number of apartments covered; and 12 is the number of months to annualize the monthly cost.

This calculation yields the full voucher cost. The incremental cost is simply the difference between the full cost and a standard Section 8 voucher, which we assumed was worth $6,900 per year on average.

Rent gap. The rent gap is calculated as the difference between estimated market rent and the maximum rent a tenant would pay under enhanced section 8 voucher rules.

Market rents were calculated for each Mitchell Lama development based on neighborhoods. We used market rent data from the 2002 annual report on the rental market published by the real estate firm The Corcoran Group, Inc. For buildings in neighborhoods included in the Corcoran rental report, we estimated the market rent at 70 percent of the Corcoran level for a two bedroom (the 30 percent "discount" was assumed because these are not new buildings and were not built to luxury standards). For all other neighborhoods, we assumed a market rent of $1,200.

The maximum tenant rent was calculated according to enhanced voucher rules, under which a household must pay the greater of the rent paid prior to buyout or 30 percent of income. We therefore set the maximum tenant rent at the greater of the average apartment rent or 30 percent of the average income of eligible households.

Average apartment rent was calculated based on the state Division of Housing and Community Renewal 2003 Annual Report on Mitchell Lama buildings, which reports the number of rooms in each building, the number of apartments, and the average rent per room. Using this data, IBO calculated the average apartment size, and the average apartment rent, for each development.

Using the 2002 Housing and Vacancy Survey, we estimated that the average income for Mitchell-Lama households that earn less than 95 percent of AMI for their family size is $21,782 per year.

IBO applied this methodology to all current Mitchell-Lama buildings (including pending buyouts) and estimated the average annual full cost of an enhanced voucher to be

$10,252. We then repeated this methodology using only the current buildings located in neighborhoods which Corcoran lists in its rental report (core Manhattan, and certain neighborhoods in Brooklyn) and the pending buyouts, on the assumption that these were the buildings most likely to leave the Mitchell-Lama program. Applying the same methodology to this smaller subset of buildings led to an average annual cost of $22,408.

Percent eligible. Under Section 8 rules, households with incomes up to 95 percent of area median income for their family size are eligible for enhanced vouchers. Using the 2002 HVS, we estimated that 79 percent of Mitchell-Lama tenants have incomes below 95 percent of area median income for their family size.

Uncertainties. There are a number of sources of uncertainty in this analysis. First, the HVS includes only a sample of 330 Mitchell-Lama rental households. This relatively small sample size could result in sampling error when estimating household income. (In addition, household income figures in the HVS are often imputed for those respondents who did not provide income data—that is, income is estimated based on other households with similar characteristics. This could also be a source of sampling error.)

If the sampled households have lower incomes than the Mitchell-Lama rental population as a whole, the cost of a city rental subsidy will be lower, because fewer households will be eligible to participate, and the portion of the market rent that those who are participating pay will be higher.

Second, it is not clear what market rents will actually be. To the extent that actual rents charged are lower than the IBO's estimate, the cost of a city rent subsidy program will be lower. Conversely, if rents are higher, the program cost would grow.

Finally, it is extremely difficult to predict which buildings will leave Mitchell-Lama, and thus create a need for a rental voucher. If more developments in the Bronx and Queens—where market rents may be only slightly higher than Mitchell-Lama rents— buy out, the cost to the city will be less. According to the city Department of Housing Preservation and Development, none of the four most recent buyout applications have been in high-cost neighborhoods.

Sensitivity Analysis
Given the uncertainty of the Housing and Vacancy Survey estimate of Mitchell-Lama tenant incomes, we undertook an analysis of the sensitivity of the estimate to different income levels. We also considered the impact on program cost of higher tenant contributions than the assumed 30 percent of income.

As income and tenant contribution rise, the average voucher cost should decline. Everything else equal, the average annual cost of an enhanced voucher for a household with an income of $45,000 contributing 40 percent of their income to rent should be less than half that of our baseline case.

In practice, however, as income and/or share of rent paid grows, some Mitchell-Lama buildings with the least expensive vouchers drop out of the analysis. The reason for this is that in certain buildings average estimated voucher costs are low, and therefore increasing income and/or tenant rent contribution effectively eliminates the rent gap—the difference between market rent and maximum tenant rent. Estimated voucher costs are low in these buildings because they are in neighborhoods with relatively lower market rents and/or have higher average existing rents. Some Mitchell-Lama residents who would receive enhanced vouchers under the baseline scenario would therefore no longer be eligible as average income or tenant contribution rise.

Average Annual Voucher Cost Under Alternative Assumptions

	Percent of Household Income Paid for Rent		
Average Household Income	30 percent	35 percent	40 percent
$21,782	$22,408	$22,010	$21,458
25,000	22,062	21,438	20,697
30,000	21,301	20,360	19,280
35,000	20,360	19,087	17,741
40,000	19,280	17,741	19,197
45,000	18,126	19,413	17,702

SOURCE: IBO.

As a result, the total program cost is relatively insensitive to changes in these parameters. For example, assume that the average income for voucher-eligible households in the 2,996 city-sponsored, Section 236, post-1973 units with pending buyouts was $40,000, and tenants were paying 40 percent of their income in rent. The total cost of a city rental subsidy would be $45.4 million, compared to $53.0 million if the average voucher cost were $22,400. The incremental cost in this scenario would be $29.1 million, as compared to $36.7 million.

One additional source of uncertainty could also affect program cost: the percent of households with incomes up to 95 percent of area median income. The share of households which are income-eligible for enhanced vouchers is a direct reflection of actual household incomes. If, as described above, actual incomes are higher than the sample included in the HVS, fewer households would presumably be eligible for a rent subsidy, thereby driving down the cost.

End Notes

[1] This figure includes some other, smaller project-based subsidy programs. Tenants in these other buildings are also generally eligible for enhanced vouchers.
[2] Under normal circumstances, only households with incomes up to 80 percent of area median income are eligible for enhanced vouchers. In "low vacancy areas" (as defined by the federal Department of Housing and Urban Development) this ceiling is raised to 95 percent of AMI. All of the Mitchell-Lama buyouts in New York City have been in low vacancy areas, therefore IBO uses the 95 percent ceiling.
[3] The Corcoran Rental Report, Year end 2002. www.corcoran.com
[4] This figure includes Mitchell-Lama buildings which did not receive Section 236 subsidies, but did get Project-Based Section 8 aid.
[5] Owners of Mitchell-Lama buildings often face significant opposition to buyouts from well-organized tenant groups, which may be less likely from Section 8 tenants, who are generally lower-income and have fewer resources to fight the opt-out.
[6] On a national basis, the Congressional Budget Office estimates the average cost of a Section 8 voucher to be $6,414. For a sample of HPD-administered standard Section 8 vouchers, the average annual cost is about $6,900. IBO has used the HPD figure because of the higher costs of the New York City rental market.
[7] IBO was only able to estimate the tax implications for eight pending buyouts. Including the other buildings would of course boost total revenue. A small number of buildings are on land owned by the Educational Construction Fund, and even after buyout, will pay the construction fund, rather than city taxes. This would lower total revenue received.